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ABSTRACT

This manual sets forth applicable administrative policies and procedures to recipients of discretionary project grants or cooperative agreements awarded by program offices in the Office of Human Development Services (HDS). It is intended to serve as a basic reference for project directors and business officers of recipient organizations who are responsible for the administration and financial management of grants or cooperative agreements. An introduction and definitions section are followed by 12 chapters: (1) Application and Grant Award Process; (2) Cost-Sharing or Matching; (3) Cost Principles and Procedures; (4) Financial Requirements; (5) Administrative Requirements; (6) Reports; (7) Public Policy Requirements; (8) Recipient Procurements; (9) Property; (10) Grant Suspension, Termination, and Closeout; (11) Audits; and (12) Appeals. Attachments making up more than half the document include Code of Federal Regulations, Title 45, Part 74, and relevant Office of Management and Budget Circulars; HDS programs covered and not covered by Executive Order 12372; Cost Principles; and Checklists for Internal Control in the areas of personnel management, payroll, accounting, budget, cash management, procurement, and property management. (NB)

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U.S. Department of Health and Human Services
Office of Human Development Services
Grants and Contracts Management Division, OMS

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DISCRETIONARY GRANTS ADMINISTRATION MANUAL

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DISCRETIONARY GRANTS ADMINISTRATION MANUAL

GRANTS AND CONTRACTS MANAGEMENT DIVISION/OMS
OFFICE OF HUMAN DEVELOPMENT SERVICES
U.S. DEPARTMENT OF HEALTH AND HUMAN SERVICES

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Introduction

This Manual sets forth applicable administrative policies and procedures to recipients of discretionary project grants or cooperative agreements awarded by program offices in the Office of Human Development Services (HDS). It is intended to serve as a basic reference for project directors and business officers of recipient organizations who are responsible for the administration and financial management of grants or cooperative agreements.

This Manual has been written specifically for recipient organizations of HDS *discretionary* grants and cooperative agreements. It is emphasized that, while much of the information contained herein applies to grant transactions on a Department-wide basis, the Manual is not designed for the HDS formula grant programs. State and local governmental recipients administering both HDS formula grant and discretionary grant programs should assure that the provisions in this Manual are applied only to their discretionary grants.

The policies and procedures included in this Manual are subject to applicable Federal laws and regulations. In the event these policies and procedures conflict with applicable Federal laws and regulations, the following order of precedence shall prevail:

1. Federal legislation
2. Federal regulations, other than 45 CFR Part 74
3. Terms and conditions of award document
4. HDS Grants Administration Manual
5. 45 CFR Part 74

The Department of Health and Human Services' (DHHS) regulation governing grants administration, 45 CFR Part 74, is directly applicable to HDS grants and subgrants. Part 74 contains certain options for implementation by HDS. HDS policy, as it relates to these options, is indicated throughout this Manual. The HDS Grants Administration Manual must, therefore, be read in conjunction with 45 CFR Part 74. In the past, HDS has implemented the requirements governing grants administration by paraphrasing or repeating 45 CFR Part 74. HDS is changing this method of implementation. Now the Manual simply provides references to Part 74. To facilitate cross-referencing from the HDS Grants Administration Manual to Part 74 and to provide an all-inclusive reference Manual for recipients, Part 74 and other relevant information are attached to this manual.

Changes to the HDS Grants Administration Manual will be issued under serially numbered Transmittal Notices, signed by the Assistant Secretary for Human Development Services. Each such Notice will describe the new material transmitted, the old material superseded, and the purpose of the change. New material will be printed in looseleaf-form, containing revised or additional pages, bearing the change number and date. When required, the HDS Grants Administration Manual will be reissued.

Any questions concerning the interpretation of a policy or its applicability to a particular situation shall be directed to the designated HDS Grants Officer.

Recipients are encouraged to maintain, or have access to, copies of the following documents which present additional guidance on policies and procedures to be used in the administration of HDS grants and cooperative agreements. These documents are available for public inspection and copying in the Health and Human Services' central and regional offices or may be obtained from the:

Superintendent of Documents
U.S. Government Printing Office
Washington, D.C. 20402

1. **Federal Register**
This publication is used to inform the public about proposed and final regulations, program announcements and other policies issued by the Office of Management and Budget, the Department of Health and Human Services and the Office of Human Development Services. Final regulations published in the *Federal Register* are included in revisions to the *Code of Federal Regulations.*

2. **Title 45 of the Code of Federal Regulations**
Title 45 includes a codification of the administrative and program regulations applicable to HDS grants and cooperative agreements.

3. **HHS Grants Administration Manual**
The HHS Manual sets forth general guidance for the management of grants and cooperative agreements awarded by agencies of the Department.

DEFINITIONS

Acquisition

As defined in 45 CFR 74.132.

Acquisition Cost

The net invoice unit price of an item of equipment, including the cost of any modifications, attachments, accessories, or auxiliary apparatus necessary to make it usable for the purpose for which it is acquired. Ancillary charges, such as taxes, duty, protective in-transit insurance, freight, and installation shall be included in or excluded from acquisition cost in accordance with the organization's regular written accounting practices.

Alteration and Renovation

Work required to change the interior arrangements or other physical characteristics of an existing facility or installed equipment so that it may be more effectively used for the project. Alteration and renovation may include work referred to as improvements, conversion, rehabilitation, remodeling or modernization.

Assistance

As defined under "Financial Assistance".

Budget Period

The intervals of time into which a multi-year period of assistance (project period) is divided for budgetary and funding purposes. Budget periods are usually 12 months long, but may be for shorter or longer periods, if appropriate.

Capital Expenditure

The cost of the asset including the cost to put it in place. Capital expenditure for equipment, for example, means the net invoice price of the equipment, including the cost of any modifications, attachments, accessories, or auxiliary apparatus necessary to make it usable for the purpose for which it was acquired. Ancillary charges, such as taxes, duty, protective in-transit insurance, freight, and installation may be included in, or excluded from, capital expenditure cost in accordance with the organization's regular accounting practices (See definitions of "acquisition cost" in 45 CFR 74.132 and OMB Circular A-122, and "capital expenditures" in OMB Circular A-21).

Code of Federal Regulations (CFR)

The *Code of Federal Regulations* (hereinafter referred to as "CFR") is a series of books published by the Federal Government which contain a codification of the final regulations published in the *Federal Register* by agencies of the Government, including HHS and HDS. The CFR is divided into 50 titles which represent broad areas subject to Federal regulations. Each title is divided into Chapters which bear the name of the issuing agency. HDS program regulations may be found in Title 45, Subtitle B, Chapter XIII.

Consultant

A person who gives advice or services for a fee, but not as an employee. The term includes guest speakers when not acting as employees of the party that engages them. Note that in unusual cases it is possible for a person to be both an employee and a consultant at the same time. That is, for certain work he or she is salaried as an employee while for other work, not as an employee, he or she receives a consulting fee from the same party.

Contract

As defined in 45 CFR 74.3. The terms "contract" and "subcontract" do not include any agreements between organizational components of the same legal entity - even if one of the components provides property or services to or for the other.

Cooperative Agreement

An award of financial assistance where "substantial involvement" is anticipated between the HDS granting office and the recipient during performance of the contemplated activity. "Substantial involvement" means that the recipient can expect Federal collaboration or participation in the management of the project. For purposes of this Manual and regulations governing HDS Programs, all policies and procedures pertaining to grants are applicable to cooperative agreements. See Federal Grant and Cooperative Agreement Act of 1977 (Pub. L. 95-224).

Cost Sharing or Matching

As defined in 45 CFR 74.51. Note that 45 CFR 74.41 and 74.42 permit program income to be generated and used as cost sharing or matching, if authorized.

Cost-Type Contract

A contract or subcontract in which the contractor or subcontractor is paid on the basis of allowable costs incurred. The term includes cost-plus-fixed-fee contracts and subcontracts. However, the term does not include any subcontracts under a fixed-price contract or subcontract.

Discretionary Grant

An award of financial assistance. In making these awards, the HDS granting office exercises judgment in approving the project, the project period, the recipient and the amount of the award. Examples of the types of projects supported through a discretionary grant include:

(1) *Demonstration* - A project to establish or demonstrate the feasibility of new methods or new types of services.
(2) *Research* - A project to develop new knowledge or to evaluate existing knowledge in new settings.
(3) *Service* - A project to support the cost of developing, organizing, establishing, providing or expanding the delivery of services.
(4) *Training* - A project to support the increase in numbers of personnel trained in techniques pertaining to the delivery of services or to the performance of functions necessary to the development of such services.

DAO

The Division of Accounting Operations located in the Office of the Deputy Assistant Secretary, Finance, Office of the Assistant Secretary for Management and Budget, HHS.

Equipment

An article of nonexpendable tangible personal property having an acquisition cost of $500 or more per unit and a useful life of more than two years. An organization may use its own definition provided that it at least includes all nonexpendable tangible personal property as defined herein. The definition of equipment for cost-sharing and matching purposes has the same meaning, except that instead of "acquisition cost," the words "market value at the time of donation" shall be substituted.

"Special purpose equipment" means equipment which is usable only for research, medical, scientific, or technical activities. Examples of special purpose equipment include microscopes, x-ray machines, surgical instruments, and spectrometers.

"General purpose equipment" means equipment which is usable for other than research, medical, scientific, or technical activities, whether or not special modifications are needed to make them suitable for a particular purpose. Examples of general purpose equipment include office equipment and furnishings; air conditioning equipment; reproduction and printing equipment; motor vehicles; and automatic data processing equipment.

Federally-Recognized Indian Tribal Government

As defined in 45 CFR 74.3.

Financial Assistance

A financial assistance relationship exists when the principal purpose of the transaction is the transfer of money or anything of value to accomplish a public purpose of support or stimulation authorized by Federal statute. This term includes grants, cooperative agreements, subgrants or subawards under cooperative agreements.

Government

As defined in 45 CFR 74.3.

Grant

As defined in 45 CFR 74.3. For purposes of this Manual, all policies and procedures applicable to grants are applicable to cooperative agreements, even though the latter term does not appear in the provision. Under discretionary grants, the following types of awards are applicable:

(1) *New* - The initial grant made in support of a project.
(2) *Continuation* - An award which adds funds to the grant and extends the grant period to support a budget period after completion of the first budget period. There are two basic kinds of continuations:

(a) *Noncompeting* - A continuation for a budget period that is within the currently established project period. These are noncompeting because they do not extend the project period by one or more budget periods.

(b) *Competing* (formerly known as competing extension) A continuation for a budget period that is beyond the currently established project period. These are competing because they add one or more budget periods to the project period as a result of a competitive review.

(3) *Supplemental* - An additional award to support an activity carried on in a currently funded budget period.

Grant Period

The period of time for which funds have been awarded. In incrementally funded projects, this means from the beginning date of the project period to the expiration date of the most recently funded budget period.

Grantee

As defined in 45 CFR 74.3.

Granting Office

(1) With respect to a grant, the program office within HDS authorized to administer grants awarded under legislative or delegated authority, and (2) with respect to a subgrant, the grantee organization.

Grants Officer

The individual designated to serve as the HDS official responsible for the business and non-programmatic aspects of particular grant project(s). The Grants Officer serves as the counterpart to the business officer of the grantee institution and is the focal point for matters such as interpretation of grant policies and provisions and ensures that generally accepted business and accounting practices are followed by the grantee. The Grants Officer works closely with the program or project officer who is responsible for the scientific, technical, and programmatic aspects of the grant project.

In accordance with the provisions of Section 201(a) of the Older Americans Act, with respect to grant actions of the Administration on Aging, the Grants Officer concurs on grant awards and correspondence for the purpose

of advising the Commissioner whether the proposed action complies with Departmental procedures established for the administration of grants.

HDS

The Office of Human Development Services within the Department of Health and Human Services. HDS administers human services programs for such groups as the elderly, children, youth, Native Americans, persons with developmental disabilities and public assistance recipients through its central and regional offices.

HHS

The U.S. Department of Health and Human Services (formerly the Department of Health, Education, and Welfare). In this Manual, HHS is also referred to as "the Department".

Local Government

As defined in 45 CFR 74.3.

Notice of Financial Assistance Awarded (NFAA)

The official HDS document that notifies the grantee or cooperative agreement recipient that an award is made. The NFAA contains or makes reference to all terms and conditions of the award, and provides the documentation for recording the obligation of Federal funds on the Department's accounting system.

Obligations

As defined in 45 CFR 74.71.

OMB

The Office of Management and Budget in the Executive Office of the President.

Outlays

Charges made to the grant or subgrant project. Outlays may be reported on a cash or accrual basis. For reports that are prepared on a cash basis, outlays are the sum of actual cash disbursements for goods and services, amount of indirect expense charged, value of in-kind contributions applied, and amount of cash advances and payments made to subgrantees and contractors. For reports prepared on an accrued expenditure basis, outlays are the sum of actual cash disbursements, amount of indirect expense incurred, value of in-kind contributions applied, and net increase (or decrease) in the amounts owed by the recipient for goods and other property received and for services performed by employees, subgrantees, contractors, and other payees.

Personal Property

As defined in 45 CFR 74.132.

PMS

The Departmental Payment Management System (which replaces the Departmental Federal Assistance Financing System (DFAFS)) operated by the Federal Assistance Financing Branch located in the Office of Finance, Office of the Assistant Secretary for Management and Budget, HHS.

Prior Approval

Written permission provided by an authorized granting office official in advance of an act that would result in either (1) the obligation or expenditure of funds, or (2) the performance or modification of an activity under the grant or subgrant-supported project, where such approval is required. Where an item of cost requiring prior

approvial is specified in the budget of an award, approval of the budget constitutes approval of that cost (See 45 CFR 74.177(b) (2)).

Private Nonprofit Organization

Any corporation, trust, association, cooperative, or other organization which (1) is operated primarily for scientific, educational, service, charitable, or similar purposes in the public interest; (2) is not organized primarily for profit; and (3) uses its net proceeds to maintain, improve, and/or expand its operations. For the purposes of OMB Circular A-122 (cost principles for nonprofit organizations), the term "nonprofit organization" excludes (1) colleges and universities; (2) hospitals; (3) State, local and Federally-recognized Indian Tribal Governments; and (4) those nonprofit organizations which are specifically excluded from coverage of OMB Circular A-122.

Project

The identified activity funded by an HDS grant which carries out the purposes of the authorizing legislation.

Project Director/Principal Investigator

A qualified individual designated by the recipient to be responsible for the overall direction of the project.

Project Officer

A granting office representative responsible for the programmatic and non-business monitoring of a recipient's performance.

Project Period

The total time for which a project under a discretionary grant has been approved for support, including any extensions.

RASC

The Regional Administrative Support Center located in each HHS regional office.

Real Property

As defined in 45 CFR 74.132. If a question arises about whether certain property should be classified as real property, the law of the state or foreign country in which the property is located governs.

Recipient

As defined in 45 CFR 74.3. This term includes recipients of cooperative agreements.

Replacement Equipment

As defined in 45 CFR 74.132.

State

As defined in 45 CFR 74.3.

Subgrant

As defined in 45 CFR 74.3. All policies and procedures applicable to subgrants refer equally to financial assistance subawards under cooperative agreements.

Subgrantee

As defined in 45 CFR 74.3.

Supplies

As defined in 45 CFR 74.132.

Suspension

Temporary withdrawal of the recipient's authority to obligate grant or subgrant funds pending corrective action by the recipient or a decision to terminate the grant or subgrant.

Termination

Permanent withdrawal of the recipient's authority to obligate previously awarded grant or subgrant funds before that authority would otherwise expire. It also means the voluntary relinquishment of that authority by the recipient. Termination *does not* include:

(1) Withdrawal of surplus Federal funds. This includes withdrawal of amounts that the grantee will not obligate before the end of the grant period or eliminating the surplus by decreasing the amount of the grant;
(2) Withdrawal of the unobligated balance by the granting office upon the expiration of an award;
(3) Refusal by the granting office to extend an award or to award additional funds (such as refusal to make a competing or noncompeting continuation, extension, or supplemental award); or
(4) Annulment, i.e., voiding of an award upon determination that the award was obtained fraudulently or was otherwise illegal or invalid from inception.

Terms of a Grant or Subgrant

As defined in 45 CFR 74.3.

Third Party

With respect to a grant, any entity except (1) the Federal Government; (2) the grantee or recipient of the cooperative agreement; and (3) subgrantees under that grant or cooperative agreement. Note that contractors of recipients are third parties under this definition, although subgrantees are not.

Unliquidated Obligations

For financial reports prepared on a cash basis, they are the amount of obligations incurred by the grantee that has not been paid. For reports prepared on an accrued expenditure basis, they are the amount of obligations incurred by the grantee for which an outlay has not been recorded.

Unobligated Balances

The portion of the Federal funds authorized which has not been obligated by the grantee during a given budget period.

CHAPTER 1
Application and Grant Award Process

A. APPLICATION PROCEDURES

Cross-reference: Subpart N of 45 CFR Part 74

1. General Discussion

Application forms and instructions for filing applications may be obtained from the HDS granting office authorized to fund projects for which the application is made. The instructions will include information concerning deadlines for submission of applications.

2. Types of Applications

a. New Applications

New applications are those submitted for a project not currently receiving HDS support. Announcements of the availability of funds to support new projects are usually published in the *Federal Register.* This announcement describes the program, the amount of funds available, eligibility requirements, where to obtain application forms, the deadlines for submitting an application, criteria for review and evaluation, funding priorities, and other information about the activity.

Occasionally, competition for grant funds is limited by HDS program legislation or by an HDS granting office official to a specific type of organization or a geographical area; e.g., accredited Schools of Social Work, Indian Tribal Governments, applicants from a particular DHHS region. In these cases, announcement of the availability of funds may be made through (1) publishing a notice in the *Federal* Register; (2) individual letters to all prospective applicants; (3) publishing notices in newspapers; or (4) other suitable forms of public notice.

b. Competing Continuation (formerly known as Competing Extension) Applications

Applications for competitive continuation of HDS financial assistance for one or more budget periods beyond the approved project period may be submitted when (1) the original project period was approved for a period of time shorter than grant support was needed, or (2) the results of the original activity warrant support beyond the period originally recommended. Except for limited competitions as discussed in subsection 2.a above, announcements of the availability of funds to support competing continuation projects are published in the *Federal* Register. Applicants compete for approval against new applications, other competing continuation applications, and any supplemental applications from current grantees requesting funds for additional activities. If approved and funded, the extended period of support is treated as a continuation of the original project period.

c. Noncompeting Continuation Applications

Noncompeting continuation applications for a grant to continue project support beyond the initial budget period but within the established project period will be mailed to the grantee approximately six months before the beginning date of the next budget period. These applications shall be submitted in accordance with program instructions. If application forms are not received by the grantee at the proper time, it is the responsibility of the grantee to request them from the appropriate HDS granting office. Noncompeting continuation applications are not subject to competitive, objective review procedures and do not compete for funds.

d. Supplemental Applications

Supplemental applications are those submitted by existing grantees during the approved project period to either (1) request support for new or additional activities which are not identified in the current grant or which significantly expand the project's scope beyond the purpose(s) for which the current grant was awarded, or (2) request support for expansion of the grant approved activities.

Supplemental applications requesting support for new or additional activities shall compete against new, competing continuation, and other supplemental applications when these project activities are within the scope of

a program announcement published in the *Federal Register*. Supplemental applications requesting support for new or additional activities which are not within the scope of a program announcement may be reviewed noncompetitively when the HDS granting office obtains proper authorization to deviate from the competitive review process and funds are available. Supplemental applications requesting support to expand the grant-approved activities within the current scope of work (no new or additional work) shall be reviewed on a competitive basis by the HDS granting office. Funding decisions will be made based on the availability of funds and HDS granting office approval.

Applications to request support for new or additional activities or to expand current grant activities may be obtained from the appropriate granting office upon request. The application must be accompanied by a detailed justification for the need to increase Federal funds, a revised budget, and revised project objectives citing the changes in project activity, as appropriate. [See "Grant Awards" in Section H of Chapter 1 for a discussion of an award for supplemental grant funds.]

3. Withdrawal of Pending Applications

An application for grant support may be withdrawn at any time by an applicant organization at the written request of an authorized grantee official. Correspondence regarding withdrawal of an application shall be addressed to the HDS Grants Office to which the application forms were submitted.

4. Recommended Level of Support

In completing the budget information on the application form, applicants shall provide estimates of Federal funds needed to support the project for future budget periods. Based on this information, the HDS granting office may choose to reflect on the "Notice of Financial Assistance Awarded" a recommended level of support for the remainder of the project period. The grantee may use the recommended level of support as the basis for requesting funds on a continuation application. However, such estimated amounts do not constitute a commitment by the HDS granting office to award future funds beyond the current budget period. Continued support for a project will be based on the availability of funds, satisfactory progress by the recipient, and a determination that continued funding is in the best interest of the Federal Government.

B. ELIGIBILITY

Human Development Services' granting offices award grants to private nonprofit organizations, institutions of higher education, Indian tribes, and other government agencies. Grants to for-profit organizations will be made only when specifically authorized by the program legislation or when the authorizing legislation is silent about the types of organizations eligible for grant awards.

Private nonprofit organizations which have not previously received HDS support must submit proof of their nonprofit status with the grant application. Any of the following is acceptable evidence of nonprofit status:

- A reference to the applicant organization's listing in the Internal Revenue Service's most recent list of tax-exempt organizations described in Section 501(c) (3) of the IRS Code.
- A copy of a currently valid Internal Revenue Service tax exemption certificate.
- A statement from a State taxing body or State Attorney General certifying that the applicant organization has a nonprofit status and that none of the net earnings accrue to any private shareholders.
- A certified copy of the organization's certificate of incorporation or similar document that clearly establishes nonprofit status, or
- Any of the above proof from a State or parent organization, and a statement signed by the parent organization that the applicant organization is a local nonprofit affiliate.

Eligibility requirements for individual grant programs are contained in the authorizing legislation and program regulations. Other limitations on eligibility by class of recipient may be administratively imposed by the granting office. Applicants should consult the appropriate program regulations or program announcement to determine if additional requirements apply. Grants inadvertently awarded to ineligible recipients will be annulled and closed out in accordance with the procedures discussed in Chapter 10 of this Manual.

C. MAINTENANCE OF EFFORT

Where required by program legislation or regulations, applications for grants must include a written assurance that the services provided under the project will be in addition to, and not in substitution for, comparable services provided without Federal assistance.

D. SALARY INFORMATION IN APPLICATIONS

Grant applications for HDS support are required to include specific salary rates or amounts for key individuals. When submitting these applications, the applicant may request the HDS granting office not to make the salary information available to the application's reviewers who are not Federal employees. To the extent permitted by law, the HDS granting office will honor such requests if the applicant:

- includes the salary information on (or attaches it to) one copy of the application which shall be identified by the words "Restricted Information";
- omits salary information from all other copies; and
- includes in all copies the following:

  (1) the names of key individuals (or position descriptions when individuals have not been selected) identified in the project narrative;

  (2) positions or job titles;

  (3) percentage of key individuals' time expected to be devoted to work on the project, and

  (4) the amount of total salary support requested from the grant.

Information regarding salaries, financial information and names of employees of funded grant applications is considered proprietary information and will not be disclosed to the public under Freedom of Information requests.

E. INTERGOVERNMENTAL REVIEW OF FEDERAL PROGRAMS

Cross-references:
- Executive Order 12372 and
- 45 CFR Part 100

1. Background

The Intergovernmental Review System established by OMB Circular A-95 was replaced by Executive Order (E.O.) 12372 "Intergovernmental Review of Federal Programs", signed by President Reagan on July 14, 1982. Under E.O. 12372 and implementing DHHS regulations published at 45 CFR Part 100, States may design their own processes for reviewing and commenting on proposed Federal assistance under covered programs. A list of HDS covered programs is included as Attachment B to this Manual. [For clarity, a list of HDS programs which are not covered by the Order is also included.]

The objectives of the new approach under E.O. 12372 are to (1) increase State flexibility to design a process and select programs; (2) increase the ability of State and local elected officials to influence Federal decisions; and (3) compel Federal officials to be more responsive to State concerns, or explain the reasons why they cannot accommodate those concerns. Nearly every State has adopted a State process and designated a State official or organization to act as the State's "Single Point of Contact" (SPOC) for coordinating and sending official State process comments and recommendations to Federal agencies. All organizations submitting applications subject to E.O. 12372 review should contact the cognizant SPOC (if one has been designated) as early as possible for instructions regarding the State's process.

2. Applicability

The requirements of this Section are applicable to all HDS discretionary programs covered by E.O. 12372 except those administered by Federally-recognized Indian Tribes. Changes and additions of covered programs in 45 CFR Part 100 will be announced in the *Federal Register*.

3. The HDS Process

a. New and Competing Continuation Awards

The responsible HDS granting office will notify the SPOCs as early as possible of the intent to issue new or competing continuation assistance awards through the publication of a program announcement in the *Federal Register*. If every eligible applicant is identifiable by the granting office, the announcement may be mailed to each of them directly instead of being published in the *Federal Register*.

The program announcement will specify the due date for comments from the SPOCs. That date will normally be the 60th day after the application deadline date. The program announcement and/or the application kit will include a current listing of SPOCs to facilitate early notification. Application kits will include information relating to compliance with the procedures described in this Section.

b. Noncompeting Continuation Awards

As early as possible, the cognizant HDS Grants Officer will notify the appropriate SPOC of the intent to make a noncompeting continuation award. For noncompeting continuations which are generally refunded on a continuous basis, e.g., Head Start, the Grants Officer will send out an early notification letter in July of each year. This letter will alert the SPOC of anticipated funding for the subsequent fiscal year beginning October 1 and will indicate the due date for comments from the SPOC. That date will normally be the 30th day after the application deadline date.

For other noncompeting continuations, HDS will notify the SPOC with a copy of the recipient's refunding guidance letter. This letter is mailed to the recipient six months prior to the continuation date, and will simultaneously be mailed to the cognizant SPOC. Again, an accompanying letter will inform the SPOC that it will have until 30 days after the application deadline date to submit comments. Current grantees receiving continuation application kits or instructions should notify the SPOC that they are applying for a noncompeting continuation award with a 30 day rather than a 60 day review period.

c. Applicant Compliance Certification

Applicants shall certify that they have contacted the cognizant SPOC by checking the appropriate box in Item 22 of SF-424, Application form for Federal Assistance. If more than one State will be served by the proposed project, the SPOC of each State in which the project will operate should be contacted by the applicant. The applicant's certification in Item 22 serves as assurance that *all* States to be served have been contacted. The Grants Officer will screen each application to ensure that the certification in Item 22 has been included, and immediately notify the SPOC of the receipt of any covered application which should, but does not, indicate that the SPOC has had an opportunity for review.

4. Handling Of State Process Recommendations: The "Accommodate or Explain Rule"

a. The "accommodate or explain" rule applies when all of the following are present:

(1) A written comment that constitutes a State process recommendation is received by the HDS official designated to receive applications.

(2) The comment is sent or transmitted by the SPOC.

(3) HHS has stated in the *Federal Register* that the program is covered by E.O. 12372.

(4) The applicant is not a Federally-recognized Indian Tribe.

(5) The comment is received not later than the established due date for State process comments.

b. If all of the factors listed in the preceding paragraph 4.a are present, the "accommodate or explain" rule is triggered even if the program is not one that was officially selected for review in the State process.

c. A mere endorsement of a grant application does not trigger the "accommodate or explain" rule. However, a comment that prioritizes or ranks applications does trigger the rule (if all of the factors listed in paragraph a above are present).

d. When the "accommodate or explain" rule applies, HDS must make every effort to accommodate the State process recommendation.

e. The HDS granting office will notify the SPOC in writing whether we accommodate or nonaccommodate a State process recommendation to which the "accommodate or explain" rule applies.

5. Accommodations

Accommodating a State process recommendation consists of either: (1) accepting and carrying out the recommendation, or (2) negotiating a mutually agreeable solution with the SPOC or State process representative.

6. Nonaccommodations

a. When Nonaccommodation Occurs

(1) The State process recommends that an application not be funded, and HDS decides to fund it; or

(2) The State process recommends substantive changes to the application or special conditions in the award and HDS decides to fund the application without these changes or special conditions; or

(3) The State process indicates that a particular application should be chosen for funding over others, and it is not funded while other, lower priority applications are.

b. Explanation reguirement

When a decision is made not to accommodate a State process recommendation, the HDS granting office must promptly send a written explanation of the reason(s) to the SPOC.

c. Delay of Implementation

A nonaccommodation decision must not be implemented for at least ten days after the SPOC is first notified of the decision. [See paragraph 7 below concerning exceptions to this rule.] This waiting period requirement is intended to provide adequate time for the State process to formulate an appropriate response if the issue is sufficiently important within the State. Every nonaccommodation explanation given to a SPOC shall notify the SPOC of the specific date after which HDS may implement the nonaccommodation decision. Neither the awards for successful applications nor the disapproval letters for unsuccessful applicants shall be mailed until after the ten day waiting period has expired.

7. Unusual Circumstances and Waivers

In unusual circumstances, the Department may allow a reduction in (1) the 60 day waiting period for new and competing continuations; (2) the 30 day waiting period for noncompeting continuations; or (3) the 10 day waiting period for nonaccommodation letters. For example, a statutory deadline, an emergency, or the end of the fiscal year may necessitate a shorter period. This authority is used sparingly to deal with unforeseen situations or problems beyond the Department's control.

F. NOTICE TO UNSUCCESSFUL GRANT APPLICANTS

Organizations whose grant applications have been disapproved or not funded will be notified in writing within 30 days after the decision is made not to fund the application. Notification of disapproval will be sent to the grantee official who signed the application. Upon request, an applicant will be provided a full explanation of the reasons for disapproval of its application.

G. COMPLAINTS AGAINST FEDERAL GRANT AWARD DECISIONS

An HDS granting office decision to disapprove a grant application may not be formally appealed to HDS or HHS, unless otherwise stated in an HDS program regulation.

H. GRANT AWARDS

1. New and Continuation Awards

HDS provides financial assistance through either a grant or a cooperative agreement. Applicants whose projects have been approved for support by the HDS program will be advised by a "Notice of Financial Assistance Awarded" which will include the identifying number; the period for which the project is intended to be supported (project period); the amount of the Federal funds awarded for the budget period; any special conditions under which the grant is made; and whether the award is a grant or a cooperative agreement.

2. Awards for Supplemental Funds (Including Low-Cost Extensions)

An award for additional funding during the current budget period may be made after a supplemental application has been submitted by a grantee, reviewed on a competitive basis, and approved by the HDS granting office. [See Section "A" of this Chapter.] If awarded, the supplemental amount becomes part of the approved budget for the current budget period.

If more time is needed to complete the work of a project, a grantee may request an extension of the budget period, unless otherwise restricted by program legislation or regulations. The sum of no-cost and/or low-cost extensions may not exceed 12 months past the original budget period ending date, unless approved by the HDS Grants Officer. These noncompeting extensions may be made without additional funds (no-cost) or with a minimal amount (low-cost) of further support, if supplemental funds are available.

To be considered "low-cost", a supplemental for a 12-month extension must not exceed 25% of the total approved budget for the current or most recent budget period. For periods of less than 12 months, the amount of funds is computed on a monthly basis prorating the 25% funding limitation, i.e., a maximum of 2.09% per month times (x) the total approved budget for the current or most recent budget period. For example, if a grant, including any supplements, totals $120,000 for the current budget period, the limit for a low-cost extension would be $30,000 for a twelve month extension, $15,000 for a six month extension, and $2,508 for a one month extension.

Note that additional low-cost extensions for the same budget period would use the same base as the initial one. If a $120,000 grant were supplemented $15,000 for six months, a second low-cost extension for six months would also be limited to not more than $15,000 and *not* $16,875 (25% of $135,000 (x).5).

Under no circumstances may low-cost extensions exceed the 25% limitation noted in paragraph 2 above. If additional funds are requested above this limitation, the application will be treated as a regular supplemental application or a competing continuation (see Section "A" of this Chapter) and will have to compete with other applications unless the granting office requests approval to deviate from the competitive review process.

I. DISCRETIONARY GRANT FUNDING

1. General Discussion

All HDS discretionary project grants are funded either by a single grant award covering the entire period of time for which assistance is approved (not to exceed one budget period) or for multi-year periods of assistance, in annual increments called budget periods. [Note: HDS program announcements generally specify the length of the project period covered by the grant award. Further information is provided for some HDS programs in the *Catalog of Federal Domestic Assistance*.] The budget period may be 17 months or less, but is usually 12 months in duration. The written approval of the Assistant Secretary for HDS or the Commissioner on Aging for Administration on Aging grants is required if a budget period exceeds 17 months (exclusive of no-cost or low-cost extensions). The initial grant covers only the first budget period. At the end of each budget period, the next budget period (if any) is funded by a continuation award.

Although funded annually, most multi-year projects do not have to recompete each year. However, at the completion of each budget period, an assessment is made to determine if the grantee is making satisfactory progress in the conduct of the project and whether continuation of the project is in the best interest of the government. At the time of the initial award, the granting office may approve the project for a project period of more than a year and the continuations within that period are awarded without further competition. The length of a project period is determined by considering the frequency of competitive review considered necessary, the total length of time for which grant support is requested, and limitations imposed by the HDS program statutes or regulations.

2. Obligation and Expenditure of Funds

Subject to each year's budget approval and any limitations or restrictions which may be imposed by the granting office, funds awarded to recipients remain available for obligation at any time during the project period with the following exceptions: (1) recipients may not obligate grant funds to conduct project activities after grant support ends, either through expiration, termination or denial of refunding; (2) HDS assumes no liability for project costs which exceed the total amount of Federal funds authorized on the Notice of Financial Assistance Awarded. [Thus, recipients should not incur costs that exceed the amount authorized in a particular budget period]; and (3) grant funds may not be used for obligations or expenditures made prior to the beginning date of an initial grant for a new project unless preaward costs are specifically provided for in the approved budget and have been approved in writing by the granting office.

The following table illustrates when an obligation that is directly charged is considered to occur for various kinds of property and services.

When Obligations Occur

If the obligation is for:	The obligation is made:
• Services by an employee of the recipient	• When the services are performed.
• Services by a contractor (except for audit services]	• On the date the recipient makes a binding written commitment to obtain the services or work; or • On the date the services are received, if there is not an advance written commitment to obtain the services.
• Audit services	• When the services are provided.
• Public utility services	• When the recipient receives the services.
• Travel	• When the travel is taken.
• Acquisition of real or personal property	• On the date the recipient makes a binding written commitment to acquire the property; or • On the date the property is received, if there is no advance written commitment to obtain the property.
• Rental of real or personal property	• When the recipient uses the property.
• A pre-agreement cost that was properly approved under the cost principles in 45 CFR Part 74.	• On the first day of the effective date of the grant/subgrant period.

3. Liquidation of Obligations

Cross-reference: Chapter 6 of this Manual

All obligations incurred by a grantee should be liquidated within ninety (90) days of the end of the project period to coincide with the submission of the final Financial Status Report (SF-269). Grantees with "indefinite" project periods (e.g., Head Start) should submit a final adjusted expenditure report 90 days after the end of each budget period. [This final adjusted report reflects the liquidation of obligations which remained outstanding at the time the fourth quarter report was submitted.]

If it is not possible to liquidate totally all obligations within the 90-day period specified for submission of a final report, grantees shall notify the HDS Grants Officer in writing and request approval for an extension of time in which to liquidate obligations. At the same time, grantees shall submit a "provisional" final report, indicating when the final report may be expected. Provisional final reports must be submitted on a quarterly basis until all obligations have been liquidated. NOTE: Failure to submit a final report within a reasonable length of time would be considered an example of poor financial management and taken into account when the fiscal performance of the grantee is evaluated. [See Chapter 6.A.2 for more information on the importance of timely reporting.]

When all obligations have been liquidated, the grantee shall submit a final expenditure report, showing $0 balance on line 10(h) of the SF-269. This $0 balance must also be reflected on the final Cash Transactions Report (SF-272 or PMS-272) which must be submitted with the final SF-269.

Cash advances or payments to subgrantees or contractors under the grant are reported on line 10(b) of the SF-269. Although such advances are considered as an outlay, i.e., a charge made to the project, a *true* liquidation of obligations has not occurred until the subgrantee or contractor has liquidated all of its obligations, and reports this back to the grantee. Therefore, the grantee must take appropriate steps to assure that subgrantees or contractors liquidate their obligations as quickly as possible and submit final expenditure reports to the grantee showing total liquidation of obligations.

If all obligations have not been liquidated at the subaward level by the time the final expenditure report is due, the grantee shall submit a "provisional" final report and put in the "Remarks" section of the SF-269 a statement that the outlays include $ (*amount*) in payments to a subgrantee or contractor for which the subawardee has not yet reported outlays. Indicate that this is a "provisional" final report and when the true final report will be submitted.

J. UNOBLIGATED BALANCES

At the direction of the HDS granting office, estimated or actual unobligated balances remaining at the end of a budget period may be processed in one of the following ways:

- As a *carryover** from the previous budget period to the current or next period and either: [*An unobligated balance from a prior period does not authorize a grantee to obligate grant funds in excess of the total Federal approved budget reflected on the Notice of Financial Assistance Awarded for the current budget period.]

(1) ***deducting*** (offsetting) the anticipated or actual unobligated balance from the Federal share of the approved budget in calculating the award amount for the next budget period, i.e., the unobligated funds carried over are used to support the next budget period resulting in the need for less new Federal funds. As an example, $10,000 in unobligated funds from a prior fiscal year would be used in place of $10,000 appropriated for the current fiscal year. This results in no dollar change in the total Federal share of the new budget period.

The determination of the amount offset may be based on the estimated or actual unobligated balance. Except in unusual and justified circumstances, the HDS Grants Officer will take action to reduce the obligational authority available by offsetting when the reported *estimated* unobligated balance exceeds twenty percent (20%) of the amount authorized (10% for authorizations in excess of one million dollars). This provision does not apply to amounts for which obligational authority has not existed for a full prior budget period. When the *actual* unobligated balance is known, the grant may be amended to reflect the correct amount of unobligated funds.

(2) ***restricting*** an amount equal to the unobligated funds from the next budget period's award. The restricted amount may be available for use in the current budget period, or may be taken into account in calculating the subsequent award, if any.

(3) ***adding*** the anticipated or actual unobligated funds to the Federal share of the approved budget (creating *additional authority* by increasing the total Federal dollars) in calculating the award amount for the current budget period.

If the unobligated balance is to be carried over as additional authority and is not reflected in the application for refunding, the grantee must submit a request for the additional funds to the HDS Grants Officer which shall include a justification for use of the unobligated balance. Such requests should normally be for one-time expenditures; e.g., purchase of a van, alterations and renovations. Guidance on the use of such funds may be obtained from the HDS granting office. Permission to carryover unobligated funds as additional authority does not represent a permanent increase in the grantee's funding level.

- As a *withdrawal* (deobligation) of Federal funds from the most recently funded budget period. [If cash has already been transferred to the grantee, the grantee must refund the unobligated funds.] This withdrawal is not a termination. It is merely an adjustment to the amount of the grant based on the latest information provided by the grantee.

- As a *withdrawal* (deobligation) of the "final" unobligated balance upon expiration or termination of grant support. After a grant expires or is terminated, the grantee may no longer obligate against the grant. Therefore, the final unobligated balance, if any, lapses and the HDS Grants Officer deobligates it.

K. TRANSFERRING WORK THROUGH SUBGRANTS OR PROCUREMENT CONTRACTS UNDER GRANTS

1. Prior Approval Considerations

Cross-references:.

- Subpart L of 45 CFR Part 74;
- "Post-Award Changes to Grants" in Chapter 1, Section L of this Manual, and
- "Granting Office Review of Proposed Procurements" in Chapter 8, Section C of this Manual

Recipients shall obtain prior approval from the granting office before transferring to others by contracting, subgranting, or any other means, the actual performance of "substantive programmatic work", as defined in Subpart L of 45 CFR Part 74. If the transfer is not explicitly included in the approved project plan at the time of the award, the approval must be obtained through a post-award request. Grantees may develop their own procedures for approving the transfer of subgrantee project activities to another party. A recipient may not act merely as a straw-party, i.e., to act as a mere conduit of funds to another party without performing a substantive role itself. Therefore, the HDS granting office shall authorize a grantee to transfer programmatic work only if the grantee will perform at least one of the following roles:

- Principal performer of project activities;

- Primary beneficiary of Federal financial assistance; or

- Overall administrator of a program in which another party performs activities or receives financial assistance.

When programmatic work is transferred by the recipient to another party, there shall be a written contract or agreement stipulating the terms and conditions of the award; the work to be performed; reporting requirements; the dollar amount of the award; and, for procurement contracts, the required contract provisions discussed in Appendices G and H of 45 CFR Part 74 and Chapter 8 of this Manual. If not included in the approved application, the grantee shall submit the following to the HDS granting office before approval can be obtained to transfer programmatic work to another party:

- name of the organization;

- purpose of contract/agreement;

- statement (scope) of work;

- period of performance;

- estimated dollar amount of award;

- completed budget Sections A & B of Part III of application and budget justification for each subgrantee; and

- grantee role in administering subawards.

2. Selecting the Proper Award Instrument

The transfer of substantive programmatic work may be accomplished through either financial assistance (subgrant) or procurement (contract). Unless precluded by statute, the recipient may choose the type of subaward instrument based on its own discretion or the organization's usual practices. Where discretion may be exercised, the nature of the intended relationship between the recipient and another party should determine the appropriate instrument to be used. Basically, it is a matter of whether the two parties stand primarily in a financial assistance (subgrant) or a buyer-seller (procurement) relationship. If the grantee intends to *assist* a lower tier party, the award should be made as a subgrant. Where a service is acquired or *purchased*, the award should be a procurement (contract). It is the relationship that counts, not the name used for the award instrument. For example, a "contract" may be the instrument used to formalize the financial assistance relationship between a grantee and a subgrantee. In this case, the term "contract" is merely a label for a subaward but it does not change the intended financial assistance relationship. Conversely, if a grantee is buying a service from another party, it is procuring that service, and a "contract" is the instrument that is used to formally express this relationship.

The granting office has the option of limiting the kinds of parties eligible to perform work transferred to another party; e.g., State governments, nonprofit organizations, institutions of higher education. However, the granting office may not select or require the recipient to select a specific party. The choice of a specific party is the recipient's.

As indicated above, the recipient chooses whether a subaward is a subgrant or a procurement contract based on the nature of the intended relationship. Two examples of HDS programs where grantees award subgrants and procurement contracts, respectively, are: (1) subawards made by Head Start grantees to "delegate agencies" reflect a financial assistance relationship; therefore, the delegate agencies are considered "subgrantees"; and, (2) subawards made by a Federally-recognized Indian tribe receiving Administration on Aging Title VI funds to a purchase-of-service provider reflect a buyer-seller relationship; therefore, the provider agencies are considered "procurement contractors".

It makes a difference whether a subaward is regarded as a subgrant or a procurement contract as different rules apply. Examples of some of the differences include, but are not limited to, the following:

In awarding subgrants:

- Grantees may use their own procedures for soliciting and selecting subgrantees. The procurement standards in Subpart P of 45 CFR Part 74 apply only to recipient procurement awards and do not apply to the awarding of subgrants.

- Unless otherwise specified, the provisions of 45 CFR Part 74 apply to subgrantees as well as to grantees. [See 45 CFR 74.4.] Examples include, but are not limited to: (1) grantees normally have to make advance payments to their subgrantees; and (2) subgrants may not be terminated by the grantee without the agreement of the subgrantee except for noncompliance with terms and conditions of the subaward.

- Grantees are required to submit to the HDS granting office for review and prior approval copies of subgrant documents which transfer "substantive programmatic work" to another party. The purpose of the review is to ensure a substantive role for the recipient and proper programmatic stewardship by the grantee.

- Grantees must verify and document proof of nonprofit status of their subgrantees, if applicable. Subgrants may not be awarded to individuals.

In awarding procurement contracts:

- Recipients are required to use one of the following in the solicitation and selection of a contractor who will perform the programmatic work: (1) small purchase procedures; (2) competitive sealed bids; (3) competitive negotiation; or (4) noncompetitive negotiation. These procedures and procurement standards are described in Subpart P and Appendices G and H of 45 CFR Part 74 and Chapter 8 of this Manual.

- Normally, costs incurred under a procurement contract are paid through reimbursements, rather than through advance payments.

- Granting offices may not require recipients to submit contract documents for prior approval if the requirements would be an unauthorized deviation from 45 CFR Part 74. Part 74 permits prior approval only in specific situations described in §74.7 and Appendices G and H to Part 74.

L. POST-AWARD CHANGES TO GRANTS

1. Prior Approval Procedures

Certain post-award project changes and budget revisions as described in this Section require prior approval from the granting office. All grantee requests that require prior approval must be submitted, in writing, to the responsible HDS Grants Officer. The HDS Grants Officer shall be responsible for reviewing the request with the HDS granting office officials and for informing the grantee of the final disposition within 30 days from the date of the receipt of the request for approval. If the decision is still under consideration at the end of 30 days, the grantee shall be notified in writing as to when to expect the decision.

The grantee will receive written notification of the approval/disapproval through a revised Notice of Financial Assistance Awarded (NFAA) or a letter. As provided in §74.102 of 45 CFR Part 74, approvals shall not be valid unless they are in writing and signed by an authorized official. In HDS, post-award approvals are usually jointly signed by the HDS Grants Officer and the HDS granting office official, but may also be signed by the Regional Administrator, the Assistant Secretary for HDS, or, for post-award requests made by AoA grantees, only the Commissioner on Aging. Grantees should assure that an authorized official's signature appears on the approval letter or NFAA. Grantees who take action without the written approval of an authorized official do so at their own risk, as such action may be subsequently disapproved by the authorized HDS official.

Grantees shall be responsible for reviewing requests from their subgrantees for the approvals required. If an action by a subgrantee will result in a change in the overall grant project or budget requiring HDS approval, the grantee must obtain that approval before giving its approval to the subgrantee. Approvals shall not be valid unless they are in writing and signed by an authorized official of the grantee.

2. Summary of Changes Requiring Prior Appproval or Notification

Except for items of cost requiring prior approval, recipients may transfer funds between and among the object class categories of the grant/subgrant approved budget without the approval of the granting office. No transfers may, however, be made which would cause the funds to be used for purposes other than those intended or which adversely affect or significantly change the grant/subgrant approved project.

There are, however, various types of changes to HDS supported projects which may occur after the grant or subgrant is awarded and which require prior approval or require that the recipient notify the Grants Officer. These changes are summarized below and in Sections L.3, L.4, and L.5.

a. Budget Changes

- Specific costs requiring prior approval in the cost principles and subsection 3.a below.
- Other budget changes requiring prior approval under Subpart L of 45 CFR Part 74.
- Transfer of funds between or among grant functions or activities.

b. Progammatic Changes

- Change in project scope or objectives.
- Change in key people.
- Providing financial assistance to another party.
- Transfer of substantive programmatic work to another party.
- No-cost/low-cost extensions to a project/budget period.
- Audiovisual activities.

- Transfer of a grant to a replacement grantee.

- Other project changes.

c. Changes Requiring Notification to Grants Officer

- Change in recipient name.

- Substantial decrease in project costs.

3. Budget Changes

The approval of a grant or subgrant budget constitutes prior approval for the expenditure of funds for specific items included in that budget. Except as provided below, HDS' recipients may make revisions between and among the object class categories within the total direct costs budget of the project, provided that the funds are used for allowable costs of the project.

a. Specific Costs Requiring Prior Approval

The cost principles prescribed in Subpart Q of 45 CFR Part 74 state that before certain types of costs are incurred, prior approval must be obtained. The cost items requiring prior approval differ somewhat among the various cost principles; consequently, different types of recipient and contractor organizations are subject to different requirements.

Unless otherwise stated in the grant award, the following *exceptions or supplements to the prior approval requirements in the cost principles* apply:

- Under OMB Circular A-21, Section J.43.f, pertaining to educational institutions, HDS waives the requirement for prior approval when expenditures for domestic travel exceed the amount allotted for such travel in the approved budget by the greater of $500 or 25%.

- For *all* HDS grants, subgrants, and contracts under grants or subgrants, prior approval is required for foreign travel costs. Each separate foreign trip must be specifically approved. For purposes of this provision, foreign travel is defined as any travel outside of Canada and the United States and its territories and possessions. However, for an organization located outside Canada and the United States and its territories and possessions, foreign travel means travel outside that country.

- For *all* HDS grants, subgrants, and cost-type contracts under grants or subgrants, prior approval is required from the granting office for general purpose equipment and other capital expenditures having an acquisition cost of $500 or more per unit and a useful life of more than two years. Prior approval is also required for special purpose equipment with a unit cost of $1,000 or more. The meaning of general purpose and special purpose equipment is in the "Definitions" section of this Manual under "Equipment".

- For *all* HDS grants, subgrants and cost-type contracts under grants or subgrants, prior approval is required for alterations and renovations exceeding $1,000.

b. Other Budget Changes Requiring Prior Approval

In addition to the items requiring prior approval under the applicable cost principles and subsection 3.a above, recipients shall obtain prior approval for any budget revisions which will:

- Involve transfer of amounts previously budgeted for student support (tuition waivers, stipends and other payments to or for trainees); or

- Involve transfer of amounts budgeted for indirect costs to absorb increases in direct costs; or

- Result in a need for the award of additional Federal funds, e.g., increasing the amount budgeted for indirect costs once a final rate is established. See Chapter 1, Section H of this Manual for a discussion of awards for supplemental grant funds.

c. Transfer of Funds Between or Among Grant Functions or Activities

Cross-reference: Chapter 6.A.2 of this Manual

Some HDS granting offices require recipients to distinguish separate grant functions or activities in the application budget and project narrative and through required financial reports. For example, Head Start requires that activities commonly identified by program accounts be broken out separately by object class category in the budget. Similarly, projects which are jointly funded by two or more HDS granting offices require separate expenditure reporting based on the percentage of participation in the total Federal approved budget by each participating HDS granting office.

In such cases, the Notice of Financial Assistance Awarded (NFAA) depicts individual common accounting numbers (CANs) which identify various programs and activities within HDS. Such a distinction is necessary to enable HDS to report Federal obligations back to specific HDS program appropriations. The NFAA generally incorporates the sum total of all of the separate functions or activities under the total Federal approved budget.

Accordingly, where separate CANs are noted on the NFAA, recipients may transfer grant or subgrant funds from one program account or discrete grant activity to another *only* with prior approval. If HDS approval is given, a revised NFAA will be prepared to reflect the transfer of funds.

4. Programmatic Changes

a. Change in Project Scope or Objectives

The recipient shall obtain prior approval for any change to the scope or objectives of the approved project. (For construction projects, any material change in approved space utilization or functional layout shall be considered a change in scope.) Changing the scope or objectives may result from a significant alteration of the approved project activities, change in the direction of the project, the types of services delivered, the number of beneficiaries to be served, or training provided.

b. Changes in Key People

The recipient of a research grant or subgrant (or any other kind of grant or subgrant if the terms of the award make this rule applicable) shall obtain prior approval 30 days (unless this time period is waived by the granting office because of unanticipated changes) in advance of the following anticipated changes:

- To continue the project during any continuous period of more than three months without the active direction of an approved project director or principal investigator. The HDS grant may be terminated if the arrangements made by the grantee are not approved by the HDS granting office.

- To permit the project director/principal investigator (or any other persons named and expressly identified as key project people in the notice of grant or subgrant award) to devote substantially less effort to the project than was anticipated when the grant or subgrant was awarded.

- To replace the project director or principal investigator (or any other persons named and expressly identified as key project people in the grant/subgrant award document). Since approval of a project may to some extent have been based on the participation and/or qualifications of the named project director or principal investigator, prior approval of the proposed alternate plans for conducting the activity is required and must be requested before the actual departure of the incumbent. The recipient shall describe the qualifications of the proposed project director or principal investigator and include a biographical sketch with the request. If the arrangements proposed by the grantee, including the qualifications of any proposed replacement, are not acceptable to HDS, the grant may be terminated.

  The recipient may also request that the grant or subgrant be terminated if the recipient does not wish to continue the project or replace the project director or principal investigator.

c. Providing Financial Assistance to Another Party by Subgranting or Any Other Means [self-explanatory]

d. Transfer of Substantive Programmatic Work to Another Party

Procedures for obtaining approval for the transfer of "substantive programmatic work" to another party after the award is made are discussed in Section K of this Chapter under "Transferring Work Through Subgrants or Procurement Contracts Under Grants".

e. No-cost or Low-cost Extensions to a Project or Budget Period

A grantee may request a no-cost/low-cost extension (see Section H.2 of this Chapter) of the budget or project period when it is determined that a project may not be effectively brought to a close within the time allotted. The request must be in writing to the HDS Grants Officer and must be submitted and approved prior to the end of the project period. Such a request must state the reasons for extending the project, the need for additional funds, if requested, and the anticipated completion date.

Extensions may not exceed twelve (12) months either individually or in the aggregate, unless otherwise authorized by the HDS Grants Officer.

f. Audiovisual Activities

Except to the extent explicitly included in the project plan at the time of award, using grant funds for any one or more of the following requires prior approval:

- Producing an audiovisual when direct production or purchase cost is in excess of $20,000 or more.

- Buying ownership of any of the rights in the work embodied in the audiovisual. [This does not apply to merely buying a license in any of the rights.]

- Regardless of the cost, presenting or disseminating to the general public an audiovisual that was produced or bought with grant support. Examples include:

  (a) Broadcast on commercial, cable, or educational television or radio;

  (b) Showing in commercial motion picture theaters;

  (c) Showing in public places such as airports, bus or railroad depots, waiting rooms, and vacation resorts, and

  (d) Showing to civic associations, schools (except when used as a teaching tool in a classroom setting), clubs, fraternal organizations, or similar lay groups.

The following does not require prior approval:

- Any audiovisual activity under a subgrant.

- The production or purchase of any audiovisual as a research instrument or to document experimentation or findings, if the audiovisual is not intended for presentation or dissemination to the general public.

A grantee's request for approval to produce audiovisual materials shall be in writing and include the following:

- name of project, grant number, and name of grantee organization;

- objectives of the project;

- subject matter of audiovisual production, and relation to project objectives;

- intended audience; kinds of places in which production will be shown;

- estimated costs;

- format, credits, length; method of production.

g. Transfer of a Grant to a Replacement Grantee

Occasionally it becomes necessary to replace a grantee prior to the expiration date of the approved project period for reasons such as the following:

- The original grantee abandons the project or becomes ineligible;

- The original grantee so seriously violates the terms of the grant that the HDS granting agency terminates for cause;

- The principal investigator for a research project transfers to another employer and the original grantee relinquishes the grant instead of appointing a replacement principal investigator satisfactory to the HDS granting office; or

- The original grantee's performance has been so poor that the HDS granting office is unwilling to award it a non-competing continuation.

The HDS granting office may transfer its support of a project to an eligible replacement grantee by means of a non-competitive award if the HDS approving official determines in writing that competition for the replacement award would not be appropriate or feasible and the following conditions exist:

- The need for the grant/subgrant-supported project that existed at the time of the award of the original grant/subgrant continues to exist at the time of the proposed award of the replacement grant/subgrant; *and*

- There will be no significant change in project activities; *and*

- The change of recipient organizations is made in a timely manner.

When the principal investigator on a research project transfers from one domestic institution to another, the project in behalf of the same principal investigator may be supported at the new institution for the remainder of the previously approved project period in an amount not to exceed that previously recommended. The change may be made without competitive review provided that (1) one of the conditions listed above under 4.g exists; (2) the principal investigator plans no significant change in research objective and level of funding for direct costs from that of the original project; (3) the facilities and resources at the new location allow for successful performance of the project; and (4) the proposed replacement grantee submits an application for support of the project.

h. Other Project Changes

In addition to the above requirements, other kinds of changes to an approved grant/subgrant project may require prior approval, as stipulated by program regulations or other terms of the award.

5. Changes Requiring Notification to Grants Officer

a. Change in Recipient Name

This change occurs when a recipient legally assumes a different organizational identity. There is no alteration to the project activities. The grantee shall provide the following documents to the responsible HDS Grants Officer:

- A copy of the instrument which effected the name change signed by the authorized official of the State having jurisdiction;

- An opinion of counsel for the grantee that the change of name was properly effected in accordance with applicable statutes; and

- A list of all affected HDS assistance projects, accompanied by a revised SF-424 (application form) showing the new grantee name and the new principal officers, if applicable.

Once the documents are received, the HDS Grants Officer shall acknowledge in writing HDS' acceptance of the name change agreement through a revision to the NFAA.

b. Substantial Decreases in Project Costs

When changes in the project result in a decrease in the anticipated project costs, the grantee should notify the responsible HDS Grants Officer. A request for a decrease of the approved budget or project costs must be accompanied with a revised budget and project objectives citing any changes in project activity.

CHAPTER 2
Cost-Sharing or Matching

A. GENERAL DISCUSSION

Cross-reference: Subpart G of 45 CFR Part 74

A number of Human Development Services' grant programs require that grantees contribute a portion of the total costs of the project (not all grants require cost-sharing or matching). This cost-sharing or matching requirement is usually prescribed by HDS program legislation and/or regulations and is stipulated in the grant agreement. The specific contribution is computed as a percentage of the total costs of the project.

B. ACCEPTABLE COSTS AND CONTRIBUTIONS

With the qualifications and exceptions listed in "C" below, a cost-sharing or matching requirement may be satisfied by either or both of the following:

- Allowable costs incurred by the recipient or cost-type contractor. This includes allowable costs borne by non-Federal grants or by cash donations from non-Federal third parties.
- The value of third-party in-kind contributions applicable to the grant or budget period to which the cost-sharing or matching requirement applies.

C. QUALIFICATIONS AND EXCEPTIONS

1. Costs borne by other Federal grants

- 45 CFR 74.53(a) specifies that a cost-sharing or matching requirement may not be met by costs borne by another Federal grant. The exception to this rule occurs when the legislative history of a program or the law itself clearly conveys the intent of Congress that such costs may be used to meet the cost-sharing or matching requirements of other programs. Federal programs which permit this usually limit such use to purposes which complement their own objectives. Recipients should be fully aware of these limitations when they consider using costs borne by another Federal program to match HDS grant funds.
- 45 CFR 74.53(a) (2) discusses the use of general revenue sharing funds, which are not considered a Federal grant, to satisfy a cost-sharing or matching requirement.

2. Costs or Contributions Counted Towards Other Federal Cost-Sharing or Matching Requirements

45 CFR 74.53(b) specifies that neither costs nor the values of third-party in-kind contributions may count towards satisfying a cost-sharing or matching requirement of an HHS grant if they have been or will be counted towards satisfying a cost-sharing or matching requirement of another Federal grant, a Federal procurement contract, or any other award of Federal funds.

3. Costs Financed by General Program Income

The limitation on the use of general program income for cost-sharing or matching purposes is discussed in 45 CFR 74.53(c).

4. Income Earned by a Contractor

Sometimes contractors under a grant or subgrant earn income from the activities carried out under the contract

in addition to the amounts earned from the party awarding the contract. No costs of services or property borne by this income may count towards satisfying a cost-sharing or matching requirement unless the other terms of the grant expressly permit this kind of income to be used to meet the requirement.

5. Special Standards for Third-Party In-Kind Contributions

45 CFR 74.53(e) discusses the requirements in order for third-party in-kind contributions to count towards satisfying a cost-sharing or matching requirement.

D. VALUATION OF THIRD-PARTY IN-KIND CONTRIBUTIONS

1. Volunteer Services

Volunteer services are services which are not paid for by the recipient or cost-type contractor vis-a-vis the paid services a recipient may use to meet a cost-sharing or matching requirement. Volunteer services may be furnished by professional and technical personnel, consultants, and other skilled and unskilled persons. Each hour of volunteer service may be counted if the service is an integral and necessary part of an approved project. The procedures for valuing volunteer services are in 45 CFR 74.54. Examples of volunteer services which may be counted as a third-party in-kind contribution include:

- The reasonable value of time donated by Head Start community members, Board, policy council, and parents in conducting the Performance Standards Self-Assessment and/or attending business meetings.

- The difference between a reduced rate or fee charged to the recipient by an individual in his/her regular line of work and the individual's standard rate or fee. For example, a medical doctor may charge a grantee a fee of $10.00 for a medical examination provided, whereas the doctor's customary and prevailing fee is $20.00. The difference of $10.00 per medical exam may be counted as a third-party in-kind contribution.

- The reasonable value of time donated by an employee of the recipient organization if (1) the individual is not compensated through regular salary, overtime, or compensatory time; and (2) the service and time donated are not within the scope of the individual's paid employment.

2. Loaned Equipment or Space

As provided in 45 CFR 74.55(b), if a third-party donates the use of equipment or space in a building but retains title, the contribution shall be valued at the fair rental rate of the equipment or space.

3. Donated Supplies

As provided in §74.55(a), if a third-party donates supplies, the contribution shall be valued at the fair market value of the supplies at the time of the donation.

4. Donated Land, Buildings, and Equipment

If a third-party donates land, buildings, or equipment and title passes to a recipient, the treatment of the donated property is as follows:

a. Donated Land

As provided in 45 CFR 74.56(b) (1), if approval is obtained from the HDS granting office, the fair rental rate of the donated land may be counted as cost-sharing or matching. If approval is not obtained, no amount may be counted for donated land. HDS gives its approval only if it determines that it would be appropriate for the party awarding the grant, subgrant, or contract to approve rental of the land as an allowable direct cost.

b. Donated Buildings

HDS granting offices *do not* allow the fair market value of donated buildings to be counted as cost-sharing or matching for HDS programs. This policy is an option used by HDS as provided in 45 CFR 74.56(b) (1). Only depreciation or use allowances based on the property's market value at the time it was donated may be counted. The depreciation or use allowances for this property are not treated as third-party in-kind contributions; instead, they are treated as costs incurred by the recipient. They are computed and allocated (usually as indirect costs) in accordance with the cost principles specified in Subpart Q of 45 CFR Part 74, in the same way as depreciation or use allowances for purchased buildings.

c. Donated Equipment

As provided in 45 CFR 74.56(b) (2), if prior approval is obtained, the fair market value at the time of donation of the equipment may be counted as cost-sharing or matching. HDS gives its approval only if it determines that it would be appropriate for the party awarding the grant, subgrant or contract to approve the fair market value of the equipment as an allowable direct cost. If approval is not obtained, only depreciation or use allowances may be counted for donated equipment.

E. APPRAISAL OF REAL PROPERTY

If appraisal of real property is required, the procedures for establishing the fair market value of land or a building or the fair rental rate of land or space in a building are in 45CFR74.57.

F. RECORDS OF COST-SHARING OR MATCHING CONTRIBUTIONS

45 CFR 74.53(d) provides the requirements for records of cost-sharing or matching contributions. Records of cost-sharing or matching contributions are subject to audit in the same manner and to the same extent as records dealing with the use of Federal grant funds.

G. COST-SHARING IN RESEARCH GRANTS

Grantees are required, by the HHS Appropriations Act, to share in the total project costs of all Departmental grant-supported research projects. Grantees may share in the costs either under (1) an institutional cost-sharing agreement, or (2) on a project-by-project basis.

1. Institutional Cost-Sharing Agreements

The institutional cost-sharing agreement covers all *research* grants awarded by agencies of the Department to a particular grantee. In exceptional cases, separate agreements for individual departments or locations of a grantee organization may be negotiated, if deemed to be advantageous. These separate agreements are referenced in the institutional cost-sharing agreement. In no case will individual cost-sharing agreements be required on projects that are covered by an institutional agreement.

The Public Health Service in the Department negotiates all institutional cost-sharing agreements on behalf of HHS granting agencies. Under an institutional agreement, the grantee agrees to maintain a stipulated average percentage contribution for all research projects. The adequacy of the grantee's overall contribution will be tested on the basis of the grantee's fiscal year. This average contribution must be consistent with the level established by the agreement. During a given fiscal year, there may be no contribution (or only a token contribution) on some grant projects, provided that the overall percentage contribution is maintained through higher contributions on other grant projects. However, there must be at least some cost-sharing on every project during the project period.

Grantees are not required to obtain prior HDS approval of the manner in which contributions are to be provided. Contributions may be made in any allowable budget category or a combination of categories; e.g., salaries, travel, equipment, supplies, indirect costs. Grantees requesting further information on institutional cost-sharing should direct their inquiries to:

Cost and Audit Management Branch
Office of Administrative Management
Public Health Services
5600 Fishers Lane
Rockville, Maryland 20852

2. Project by Project Agreements

Unless otherwise specified in a program announcement, cost-sharing arrangements for individual research projects shall be negotiated separately with the HDS Grants Officer. The agreement will cover the entire project period (including all noncompeting continuation or supplements) and will provide for the percentage of total project costs, i.e., the combined Federal and grantee non-Federal share, which the applicant proposes to contribute to the planned research. There may be no contribution in some years of the project period, provided that the agreed overall percentage for the project

as a whole is met. Separate cost-sharing arrangements will not be required for noncompeting continuations and supplements.

The grant will not be awarded until the applicant and the HDS Grants Officer have agreed to a cost-sharing percentage for the project. This agreed percentage will be specified in the "Notice of Financial Assistance Awarded" and will signify acceptance of the applicant's cost-sharing arrangement.

The amount of the grantee' s cost-sharing during the period covered by a SF-269, Financial Status Report, shall be indicated on that report. If the grantee did not cost-share during the period, "no cost-sharing" should be written on the appropriate line of the SF-269 form.

If a grant is terminated or a continuation grant is denied refunding, the negotiated cost-sharing percentage will apply to the actual period of Federal support. However, in these cases, the HDS Grants Officer may retroactively approve lower percentages to avoid unanticipated hardships on recipients.

CHAPTER 3
Cost Principles and Procedures

A. BASIC CONSIDERATION

Cross-references:
- Subpart Q of 45 CFR Part 74 and
- Attachment C of this Manual

1. General Discussion

The costs of a grant or subgrant-supported activity are comprised of its allowable direct costs plus its allocable portion of allowable indirect costs, less applicable credits. The principles for determining allowable costs are prescribed in Subpart Q of 45 CFR Part 74 under five separate sets of cost principles. Each grantee is subject to only one set, according to the classification of that grantee. A subgrantee or cost-type contractor receiving funds under an HDS grant is subject to the cost principles according to its classification, which may not necessarily be the same as that of the grantee. For example, where a State government awards a subgrant or cost-type contract to an institution of higher education, OMB Circular A-21 would apply to the costs incurred by the institution of higher education while OMB Circular A-87 would apply to the costs incurred by the State. To be allowable, costs must be: (1) reasonable; (2) consistently treated; (3) allocable; (4) determined in accordance with generally accepted accounting principles; and (5) in compliance with any limitations or exclusions set forth in the applicable cost principles, program regulations, legislation, or this Manual.

2. Prior Approval Requirements

The cost principles prescribed in Subpart Q of Part 74 state that before certain types of costs are incurred, prior approval must be obtained. These prior approval requirements are discussed under "Post-Award Changes to Grants" in Section L of Chapter 1 of this Manual. Prior approval is also required for certain programmatic changes and budget revisions under Subpart L of 45 CFR Part 74.

B. INDIRECT COSTS

Cross-references:
HHS/GAM Chapters 6-100, 6-110, 6-120, 6-150, and 6-160

1. General Discussion

Indirect costs are those costs of an organization which are not readily identifiable with a particular project or program but nevertheless are necessary to the general operation of the organization and the conduct of its activities. The costs of operating and maintaining buildings, grounds, and equipment; depreciation; and administrative salaries are types of expenses which are usually treated as indirect costs.

In theory, all of these costs might be charged directly; however, practical difficulties frequently preclude this approach. Therefore, these costs are usually grouped into a common pool(s) and distributed to benefiting organizational activities through a cost allocation process. The end product of this allocation process is an indirect cost rate which is then applied to individual projects to determine the amount of indirect costs applicable to the projects.

The indirect cost rate is the ratio, expressed as a percentage, between the indirect costs and a direct cost base, commonly either direct salaries and wages or total direct costs, excluding capital expenditures and other distorting items (such as major subawards and flow-through funds). These base adjustments are necessary to ensure an equitable allocation of indirect costs based on relative benefits received. A definition of the direct cost base (e.g., the types and/or amounts of distorting items to be excluded from the direct cost base) will be agreed upon as part of the approval process in establishing the organization's indirect cost rate(s) and will be contained in the Rate Agreement.

An indirect cost rate is established on the basis of an indirect cost proposal submitted by grantees to the Department's Regional Division of Cost Allocation for the region in which the organization is located. (If the grantee

is under the indirect cost negotiation cognizance of a Federal agency other than HHS, its indirect cost proposals should be submitted to that agency.) Indirect costs are reimbursed to an organization based on its established rate, subject to administrative and legislative limitations, as part of the costs of individual grants and contracts awarded by the Department.

Recipients must submit indirect cost proposals for each fiscal year in which indirect costs are claimed. Exceptions to this requirement for certain local government agencies and training grants are specified in HHS/GAM Chapters 6-100-50A and 6-160 (copies of these Chapters may be obtained from the HDS Grants Officer). Grantees that fail to comply with this requirement will be deemed as not having a currently effective indirect cost rate. In the absence of this rate, future grants awarded to the grantee will not provide for the reimbursement of indirect costs. If a rate is subsequently established, based on the late submission of an indirect cost proposal, indirect cost reimbursement will be limited to the indirect costs applicable to the period subsequent to the date the proposal is submitted. Failure to submit a timely proposal may also result in the disallowance of indirect costs previously reimbursed based on the use of a provisional indirect cost rate.

Guidance on the preparation and submission of indirect cost proposals is provided in an indirect cost guide for each type of grantee organization which can be obtained from the Regional Division of Cost Allocation.

2. Provisional Rate

In some cases, a provisional (temporary) indirect cost rate is used to fund and report the approximate amount of indirect costs applicable to a grant until a permanent (final, fixed, or predetermined) indirect cost rate is established. Indirect costs based on provisional indirect cost rates are subject to adjustment when a permanent rate is established. The indirect costs previously reimbursed based on the provisional rate will be disallowed if the recipient fails to establish a permanent rate.

If the difference between a provisional rate and a permanent rate results in the need for funds in excess of the total amount awarded under a grant, such funds will be provided to the grantee *when they are available* from the same appropriation from which the grant was awarded.

3. Indirect Costs on Subawards

Indirect costs may also be paid on a subaward, i.e., subgrants and cost-type contracts, under a grant-supported project. If a subaward provides for the reimbursement of indirect costs, the grantee will normally be responsible for negotiating and approving appropriate indirect cost rates with the subgrantee or contractor. Such rates shall be based on the cost principles prescribed in Subpart Q of Part 74 applicable to the subgrantee or contractor. The procedures followed by the grantee in conducting the negotiations will be subject to review and audit by, or on behalf of, HHS.

If the grantee requires assistance in connection with the negotiations, assistance may be requested from HHS' Regional Division of Cost Allocation. Grantees are not required to negotiate indirect cost rates with subgrantees and contractors if any of the following conditions exist:

- The subaward does not provide for the reimbursement of indirect costs;
- The subaward is a subgrant for training purposes (unless the subgrantee is a State, local or Indian Tribal Government agency); or
- The subgrantee/contractor is also a direct recipient of an HHS grant or contract and must negotiate indirect cost rates or research patient care rates directly with the HHS Regional Division of Cost Allocation.

4. Exceptions

HDS grants provide full reimbursement of indirect costs with the following exceptions:

- Indirect cost reimbursement on training grants and subgrants to organizations other than State and local government agencies is limited to the lesser of an organization's actual indirect costs or 8% of total allowable direct costs, exclusive of traineeship costs (see next paragraph below) and expenditures for equipment. Where actual indirect costs exceed 8% total direct costs, excess (unreimbursable) indirect costs may be used to satisfy the grantee's cost-sharing or matching requirement, if applicable.
- Indirect costs are not reimbursed on traineeship awards, i.e. tuition, stipends, student-related travel, fees, and dependency allowances.

- Indirect costs on programs subject to legislative or regulatory restrictions on indirect cost reimbursement will be reimbursed in accordance with those restrictions, e.g., a statutory limitation on administrative costs.

- Indirect costs are not reimbursed on grants to organizations located outside the territorial limits of the United States.

- Indirect costs are not reimbursed on construction grants.

5. Application of Indirect Cost Rates

The dollar amount of indirect costs applicable to a grant or subgrant-supported project will be determined by multiplying the appropriate indirect cost rate(s) by the direct cost base of the project.

In applying indirect cost rates to individual grants, the rates established for the periods in which the direct costs are actually incurred under the grants will be applied to those costs. Consequently, when a grant budget period does not coincide with the recipient's fiscal year, it is necessary to use two rates in computing the amount of indirect costs applicable to the grant, i.e., the rates established for the two fiscal years during which the grant was performed.

6. Settlement of Indirect Costs

Each grant expenditure report (SF-269) submitted by the grantee will reflect the proper amount of indirect costs applicable to the grant based on the most current rate(s) available at the time the report is submitted. If a provisional rate is used in the report, an adjustment will be necessary when a permanent rate applicable to the grant is established. In these cases, the grantee will submit a summary expenditure report adjustment sheet reflecting the adjustments to each grant (upward or downward) resulting from the differences between the provisional rate and the permanent rate (submission of revised individual expenditure reports to reflect the adjustments is not required). This sheet will be submitted to the Indirect Cost Management Section, Office of Financial Management, National Institutes of Health (NIH), Building 31, Room B1B07, Bethesda, Maryland 20205, within one year after the Negotiation Agreement establishing the permanent rate is executed and will cover all grants affected by the Agreement.

A separate adjustment sheet will be submitted for each Federal fiscal year covering the grants having a budget period beginning within that year. In addition, if adjustments are required by more than one HHS granting agency; e.g., HDS, the Health Services Administration, NIH, a separate adjustment sheet will be submitted for each agency. All adjustment sheets, including those for other granting agencies, will be submitted to NIH, which will be responsible for coordinating the reviews of the sheets by the appropriate agencies. Upward adjustments will not be considered if the adjustment sheet(s) is not submitted within the one year period. Questions regarding these adjustments should be directed to NIH.

C. DIRECT COSTS

A direct cost is any cost which can be identified specifically with a particular project or activity, or which can be directly assigned to the project or activity relatively easily with a high degree of accuracy. Costs identified specifically with a grant or subgrant-supported project are direct costs of the project and may be charged directly thereto. Costs identified specifically with other work of the organization are direct costs of that work and are not to be charged to the grant either directly or indirectly.

Costs charged as direct costs to Federally-supported projects must be consistently treated as direct costs for other work of the organization in order to preclude an overcharge to the Government as a result of Federal participation in the indirect cost pool.

D. ALLOWABLE COSTS

Provided below are *examples* of allowable costs commonly incurred by HDS recipients as direct costs in the conduct of an approved project. For certain recipients, some of these costs may be treated as indirect costs. The types of costs which are often treated as indirect are designated by an asterisk (*).

All costs are subject to the cost principles prescribed in Subpart Q of 45 CFR Part 74. Recipient organizations should consult the appropriate cost principles for specific guidance on allowable and unallowable costs and should consult with the appropriate HDS Grants Officer if there are questions concerning the allowability or treatment of a particular item.

(*) Advertising

For: (1) recruitment of staff, trainees under training programs, human subjects for research grants, (2) disposal of surplus materials; (3) procurement of goods or services; and (4) other purposes specifically permitted by the terms of the grant. Other types of advertising costs are unallowable. [See "Unallowable Costs" in Section "E" of this Chapter.]

Advisory or Policy Councils

Costs incurred by advisory or policy councils to carry out grant programs. These costs may include travel, subsistence, and costs incidental to attending meetings.

Alterations and Renovations

Alteration and renovation costs may be charged to the project provided they meet the cost principles' general standards of reasonableness, necessity, and allocability, and the following special conditions:

(1) The grant is not awarded to a foreign organization.

(2) The building has a useful life consistent with project purposes and can be readily modified to meet program requirements.

(3) The alteration and renovation is incidental to and essential for the recipient's project, no other suitable space is available, and the space involved will actually be occupied by the project. Costs may be considered incidental if the amount budgeted or used for alteration and renovation in any budget period does not exceed the lesser of $150,000 or 25 percent of the total direct costs approved for the entire project period. In the case of projects supported for an indefinite project period, the amount budgeted or used for alteration and renovation in any budget period shall not exceed 25 per cent of the total direct costs approved for that budget period; and

(4) Prior approval is obtained if the costs of the alterations and renovations exceed $1,000.

In connection with existing buildings, alteration and renovation costs shall be limited to the costs of work required to (1) make nonstructural changes; (2) improve facilities on the property; or (3) install equipment. The costs of structural changes to foundations, roofs, floors, or exterior or load-bearing walls, and the costs of extending a building to increase its floor area, are unallowable.

Under the grantee's accounting system, certain costs of installing equipment may be listed as either equipment costs or alteration/renovation costs. These include the temporary removal and replacement of wall sections, door frames, etc., in order to place equipment in its permanent location. The costs of connecting utility lines, replacing finishes and furnishings, and installing any accessory devices required for the equipment's proper and safe utilization may be considered either equipment costs or alteration and renovation costs.

(*) Audits

Costs for a CPA or other independent auditor to review and analyze recipient financial and administrative policies, practices, procedures, and records.

(*) Bonding

When required by regulations or recipient organization policy.

(*) Books and Periodicals

When required for the conduct of the project. If the organization has a library, direct charges for books and periodicals are allowable only where the organization can show that the books and/or periodicals cannot be provided as a normal library service. Such items are generally treated as indirect costs when they are provided by libraries of the organization.

Child Care Costs

Where authorized by the recipient's written policies, child care costs to allow authorized participants or representatives to attend official board or council meetings, subject to limitations in program guidelines or regulations.

(*) Communication

Costs of telephone calls, telegrams, postage, and other communication costs necessary to the project.

Consultant Services

Payments including fees, travel expenses and related costs for individuals other than employees providing service to the project. A complete discussion of consultant services is included in Section C, Chapter 5 of this Manual.

(*) Depreciation or Use Charges

Recipients shall be compensated for the use of recipient-owned facilities through depreciation or use allowances. Methods of computation for such costs are included in the applicable cost principles.

(*) Dues

For recipient organization membership in professional organizations or societies, if it can be shown that such membership is necessary to accomplish the purposes of the project.

Educational/Cultural Activities

Costs associated with trips to museums, field trips, cultural events, and other educational activities, provided such activities are part of the approved program.

Equipment

When required for project activities and subject to prior approval requirements in Section L, Chapter 1 of this Manual.

(*) Equipment Maintenance and Repairs

For equipment used specifically on HDS supported projects where necessary to keep the equipment in efficient operating condition.

Food Service

Provided food services are part of the approved program. To the extent that the recipient receives reimbursement for food costs, such reimbursement shall be credited to costs of the grant or subgrant program.

Fringe Benefits

The employer's share to the extent that the benefits are provided under established and consistently applied policies of the recipient organization. Some common examples of fringe benefit costs are:

(1) *Employee sick, vacation, and other leave costs* may be accumulated on an accrual basis or a cash basis provided that an established written policy is consistently applied on an organization-wide basis. Under an accrual accounting system, the costs are recorded when leave is earned. [This meets the requirements of generally accepted accounting principles concerning liability for employees' compensation for future absences.] Under a cash accounting system, the costs are recorded when leave is taken by an employee and paid by the employer.

(2) *Pension costs* are allowable provided the benefits are reasonable, are provided according to the established policies of the organization, are consistently applied regardless of the source of funds, and conform to the standards in the cost principles.

Indemnification

Securing the organization against liabilities to third persons (e.g., judgment or settlement costs) and any other loss or damage is allowable only when (1) specifically provided for in the award or approved by HDS, and (2) the liabilities are not covered by insurance. HDS reviews each situation on a case-by-case basis. The granting office may consider these indemnification costs as allowable only if it can be demonstrated that the costs are necessary to operate the grant program and the recipient acted prudently under the circumstances.

(*) Insurance

Premium costs for general liability, vehicle liability, fire and theft, property damage, and other insurance. Some HDS grant programs have specific insurance requirements and reference should be made to applicable program regulations or guidelines. [See Section I of Chapter 4.]

(*) Legal Costs

The costs of legal services, where required in the administration of a grant-supported project, is allowable if reasonable and supported by adequate documentation regarding the need for such services. Costs may include retainer fees if supported by evidence of bona fide services available or rendered. The legal costs of pursuing an administrative action (e.g., a grant appeal) are allowable. Certain legal costs are unallowable. [See Section "E" of this Chapter.]

Motion Picture Production

Subject to the specific limitations on audiovisual materials. [See Section L, Chapter 1 for further discussion.]

Overtime Pay

Provided such compensation is consistent with the policies of the recipient organization and is applied to all activities regardless of the source of funds. However, overtime pay is not allowable for faculty members at institutions of higher education. In the case of nonprofit organizations subject to the cost principles in OMB Circular A-122, overtime premiums require prior approval except under the circumstances described in Attachment B, Section 27 of Circular A-122.

Page Charges

Page charges for articles and other papers in professional journals provided both of the following conditions are met:

(1) The article/paper reports work supported by the grant, and
(2) Charges for publication by the journal are levied impartially on all papers published by the journal, whether or not by government sponsored authors.

Publications

Costs may include special plates, diagrams, reprints, and charts. Costs of publishing books, monographs, and pamphlets reporting the work are subject to policies concerning copyrights and disposition of program income. In the case of nonprofit organizations subject to the cost principles in OMB Circular A-122, publication costs, other than page charges in professional journals, require prior approval. [See Circular A-122, Attachment B, Sections 28 & 37.]

Registration Fees

For professional meetings, when it can be shown to be necessary to accomplish project objectives.

(*) Relocation

Transportation costs for employees, dependents, household goods, and other costs associated with relocation, when such costs are normally paid by the recipient regardless of the source of funds.

(*) Rental of Equipment and Facilities

Rental costs, except as provided in paragraphs (1) through (3) below, are allowable to the extent that the rates are reasonable, considering such factors as rental costs of comparable property; market conditions in the area; alternatives available; and the type, life expectancy, conditions, and value of the property.

(1) Rental costs under "*sale and lease-back*" arrangements are allowable only up to the amount that would be allowed under the applicable cost principles had the lessee continued to own the property. A sale and lease-back arrangement is one under which property owned by an organization is sold to and leased back from another organization or individual.

(2) Rental costs under "*less-than-arms-length*" leases are allowable only up to the amount that would be allowed under the applicable cost principles had title to the property vested in the lessee. A less-than-arms-length lease is one under which one party to the lease agreement is able to control or substantially influence the actions of the other. Such leases include, but are not limited to, those between (a) divisions of an organization, (b) organizations under common control through common officers, directors or members, and (c) an organization and a director, trustee, officer, or key employee of the organization, or his/her family, either directly or through corporations, trusts, or similar arrangements in which they hold a controlling interest.

(3) Rental costs under "*material equity*" leases are allowable only up to the amount that would be allowed under the applicable cost principles had the lessee purchased the property on the date the lease agreement was executed (e.g., depreciation or use allowances, maintenance, taxes, insurance, excluding unallowable costs). A material equity lease is one under which the lessee acquires a material equity in the leased property. A material equity in the property exists if the lease is noncancelable, or is cancelable only upon the occurrence of some remote contingency, and has one or more of the following characteristics:

- The lessee has the right to purchase the property for a price which at the beginning of the lease appears to be substantially less than the probable fair market value at the time it is permitted to purchase the property (commonly called a lease with a bargain purchase option).

- Title to the property passes to the lessee during or after the lease period.

- The term of the lease (initial term plus periods covered by bargain renewal options, if any) is equal to 75% or more of the economic life of the property, i.e., the period the property is expected to be economically usable by one or more users.

NOTE: The definition of "material equity leases" in this paragraph differs from the definition of this term in the cost principles for educational institutions (OMB Circular A-21). For these institutions, the definition in Circular A-21 shall govern.

Salaries and Wages

Salaries and wages paid to employees of an organization for services provided in connection with a grant or subgrant supported activity. Such compensation must be consistent with the salaries and wages policy of the recipient organization applied to all activities regardless of the source of funds. Amounts charged to projects for salaries and wages must be based on organizational payrolls, documented and approved in accordance with generally accepted practices. Documentation standards and requirements are specified in the appropriate cost principles.

Supplies

Expendable materials and supplies used in connection with project activities. Certain types of supplies, such as general office supplies, are frequently treated as indirect costs.

(*) Taxes

When related to employment, services, travel, renting, or purchasing for the project. However, organizations must avail themselves of tax exemptions for which activities supported by Federal funds may qualify or for which the organization may be entitled by virtue of its status as a nonprofit organization.

(*) Transportation of Goods

Costs incurred for freight, express, cartage, postage, and other transportation services relating to goods purchased or delivered. Additionally, the costs associated with the movement of equipment from one recipient to another when approved by the granting office.

Travel

Travel costs are limited to the extent provided by written organizational travel policy. The organization's travel policy must be reasonable and consistently applied to all organizational activities, regardless of the source of funds. If the organization has no written travel policy, Federal travel regulations (FTRs), including maximum per diem and subsistence rates, shall be used in determining the amount that may be charged to the project. This information may be requested from the HDS Grants Officer.

Costs may include transportation, lodging, and subsistence expenses incurred for business-related travel by employees or officials of the recipient organization. First class air travel is unallowable except under conditions specified in the cost principles.

Transportation costs for clients or other eligible beneficiaries to service delivery sites are allowable, subject to HDS program regulations. The purchase of motor vehicles for this purpose (or any other purpose) is subject to the prior approval requirements applicable to equipment discussed in Subpart L, Chapter 1 of this Manual.

E. UNALLOWABLE COSTS

Provided below are *examples* of unallowable costs which might be incurred in connection with grant or subgrant supported activities. Federal funds generally may not be used for these purposes, nor may such costs be used to meet cost-sharing or matching requirements. Recipients should consult the appropriate cost principles for specific guidance on allowable/unallowable costs.

Advertising

Costs of direct mail, exhibits, newspaper, magazine and radio or television advertisements. Exceptions are included under "Allowable Costs" in Section D of this Chapter.

Bad Debts

Losses (whether actual or estimated) arising from uncollectable customers' accounts and other claims, legal costs, and other related costs.

Construction

Not allowable unless specifically provided for in the HDS program legislation.

Contingency Fund Reserves

Funds for possible future events or conditions arising from presently known or unknown causes, the outcome of which is indeterminable. This restriction does not apply to (1) pension funds; (2) accrued costs such as accruals for earned leave; or (3) self insurance reserves.

Contributions and Donations

Charitable contributions and donations are unallowable.

Entertainment

Cost of amusements, social activities, ceremonials, and incidental costs relating to entertainment, such as meals, lodgings, rentals, transportation, and gratuities.

Fines and Penalties

Fines and penalties resulting from violation or failure of the organization to comply with Federal, State, and local laws and regulations.

Fund Raising

Costs of organized fund raising including financial campaigns, endowment drives, solicitation of gifts and bequests, and similar expenses incurred solely to raise capital or obtain contributions.

Honoraria

An honorarium is considered a payment or reward where the primary intent is to confer distinction on, or to symbolize respect, esteem, or admiration for, the recipient.

Influencing Legislation

The HHS Appropriations Act contains language which has the effect that costs of influencing Congressional legislation are unallowable. Also, since influencing legislation at the State or local government level generally does not benefit HDS programs, the cost of these activities would, in most cases, be unallowable.

Interest Costs

Costs incurred for interest on borrowed capital or temporary use of endowment funds is unallowable except as follows:

(1) In the case of State, local, and Federally-recognized Indian Tribal Governments, interest costs associated with the acquisition of publicly owned buildings which are newly occupied on or after October 1, 1980 are allowable if a "rental rate" system or equivalent system reflecting actual costs is used. [See Sections C.2.a and D.7 of Attachment B of OMB Circular A-87.]

(2) In the case of educational institutions, subject to the cost principles in OMB Circular A-21 (subsection J.17e), the cost of interest paid to an external party is allowable where associated with the following assets, provided the

assets are used in support of sponsored agreements and the total cost (including depreciation or use allowance, operation and maintenance costs, interest, etc.) does not exceed the rental cost of comparable assets in the same locality.

(a) Buildings acquired or completed on or after July 1, 1982.

(b) Major reconstruction and remodeling of existing buildings completed on or after July 1, 1982.

(c) Acquisition or fabrication of capital equipment (as defined in paragraph J.13, "Equipment and other Capital Expenditures") completed on or after July 1, 1982, costing $10,000 or more, if agreed to by the [Federal] Government.

Legal Costs for Certain Purposes

Costs incurred in connection with defense of antitrust suits, and costs incurred in the prosecution of claims against the Federal Government are unallowable. Costs of legal services incurred in connection with patent infringement litigation, organization, and reorganization, are unallowable unless otherwise provided for in the award.

Purchase of Land or Buildings

Acquisition cost for real property is unallowable except as may be specifically authorized by the HDS program legislation. However, depreciation or use allowances on buildings are allowable costs.

CHAPTER 4
Financial Requirements

A. GRANT AND SUBGRANT PAYMENTS

Cross-reference: Subpart K of 45 CFR Part 74

1. Payment Systems

HDS makes payments to grantees through either the HHS Payment Management System (PMS), the Division of Accounting Operations (DAO), or the Regional Administrative Support Center (RASC) depending on such factors as the type of grant, where the grant is awarded, the aggregate dollar amount of HHS or HDS awards, the length of the anticipated relationship, and the financial management capabilities of the grantee. The grantee is notified in writing on the back of the Notice of Financial Assistance Awarded of how payments will be made under the award.

PMS uses the *single* letter-of-credit method or Treasury check issue for financing qualifying grantees. PMS does not make payments on a reimbursement basis. PMS is designed to operate under a cash pooling concept, i.e., cash on hand for a grantee is not identified by individual program awards. The cash is pooled and available for use for all the grantee's PMS financed awards on an overall basis. Cash held in the pool is the minimum required to meet the grantee's immediate disbursements for all awards financed through PMS.

Grantees not funded through PMS will be paid through either DAO or RASC. DAO is responsible for payments to: (1) HDS grantees advanced funds by *individual grant* letters-of-credit; (2) HDS central office Head Start and Native American grantees; and (3) HDS foreign grantees. HDS regional office grantees not paid by letter-of-credit are funded through the RASC.

2. Method of Payment

The grantee will be advised of the method to be used by HDS to make payments under the grant. The HDS Grants Officer will make the determination of the appropriate payment method to be used. Consideration will be given to the type of grantee organization, size of grant, past business practices of grantee, and other considerations.

The types of payment methods used are briefly described below:

(1) *Letter-of-Credit*

The letter-of-credit is a document which authorizes a recipient to submit payment vouchers through its commercial bank to a Federal Reserve Bank or Branch for deposit of cash in the grantee's commercial bank account. The letter-of-credit is a commitment certified by an authorized official of HHS indicating a dollar amount available to a designated grantee for a specified time period. A grantee must meet the requirements specified in 45 CFR 74.93 to qualify for advance funding by letter-of-credit.

(2) *Advance by Treasury Check*

When a grantee does not meet the conditions specified in 45 CFR 74.93(a) (1) for a letter-of-credit, cash advances shall be made by the direct Treasury check method. Payment is made directly to the grantee by a check issued and mailed by the U.S. Treasury. PMS requires that grantees submit requests for payment monthly on the PMS 270. For grants paid through DAO or RASC, advances are made through either (1) receipt of the SF-272; or (2) payment schedules submitted for new awards; or (3) by the grantee regularly submitting the SF-270, "Request for Advance or Reimbursement".

(3) *Reimbursement by Treasury Check*

If a grantee does not meet the conditions stated in 45 CFR 74.93 for advance funding, payments shall be made by Treasury check as reimbursement for actual cash disbursements. The grantee may submit its request for reimbursements monthly and may submit them more often if authorized. The grantee will be paid as promptly as possible, ordinarily within 30 days after receipt of a proper request for reimbursement. [See 45 CFR 74.96(b) (1).]

The grantee shall not request reimbursement for the Federal share of amounts withheld from contractors to ensure satisfactory completion of work until after it makes those payments. [See §74.96(b) (2) for further information.]

3. Instructions for Requesting Payments

a. Letter-of-Credit

Whether paid through single letter-of-credit (PMS) or an individual grant letter-of-credit (DAO), a grantee submits Treasury TFS Form 5401, "Payment Voucher on Letter-of-Credit" to the grantee's commercial bank each time cash is to be drawn.

b. Treasury Check Advances

(1) *Through DAO or RASC*

At the time of a new award, the HDS Grants Officer sends a payment authorization package containing the grantee's forecasted cash needs for the first four months of the award to DAO or RASC. DAO or RASC makes out a schedule of payments based on the forecasted cash needs and sends it to Treasury, where a check is automatically issued to the grantee at or near the beginning of each month. Subsequent payment requests in three month increments are provided by the grantee as part of the quarterly SF-272, Federal Cash Transactions Report, which are in turn forwarded by DAO or RASC to Treasury. If the grantee submits the SF-270 to request payments, a check is released to the grantee after the form is received and processed.

(2) *Through PMS*

Grantees paid in advance by Treasury check through PMS will receive instructions for requesting payments with the transmittal of the grant award. These payments will be based on the submission of the PMS 270 form, "Request for Advance or Reimbursement", which will be furnished to the grantee when the grant award is entered into the PMS system.

c. Reimbursement by Treasury Check

The required forms for payment by reimbursement are discussed in §§74.75(a) (2) and 74.76 of Part 74.

4. Cash Expenditure Reporting

Each of the above payment systems includes a requirement for reporting grantee cash expenditures. [See Chapter 6 of this Manual.] Failure of a grantee to comply with the appropriate reporting requirements may result in a decision to pay the grantee on a reimbursement basis rather than in advance.

5. Withholding Payments

Cross-reference: 45 CFR 74.95

Unless otherwise required by Federal statute, payments for proper charges incurred by grantees will not be withheld unless:

(1) the grantee has failed to comply with Federal reporting requirements; or

(2) the grant is suspended pursuant to 45 CFR 74.114; or

(3) the grantee owes money to the United States and collection of the debt by withholding grant payments will not impair the accomplishment of the objectives of any grant program sponsored by the United States.

Cash withheld for failure to comply with reporting requirements but without suspension of the grant will be released to the grantee upon subsequent compliance. When a grant is suspended, payment adjustments will be made in accordance with §74.114. When a debt is to be collected, HDS may withhold payments or require appropriate accounting adjustments to recorded grant cash balances for which the grantee is accountable to the Federal Government, in order to liquidate the indebtedness.

6. Payments to Subgrantees

Cross-reference: 45 CFR 74.97

Grantees shall observe the requirements stated in Subpart K of 45 CFR Part 74 in making (or withholding) payments to subgrantees, with the following exceptions:

- The forms specified in Subpart I of 45 CFR Part 74 and in Chapter 6 of this Manual for requesting advances and reimbursements are not required to be used by subgrantees;
- Advance payment by check may be used instead of letter-of-credit; and
- The reimbursement by check method may be used to pay any construction subgrant, whether or not HHS has agreed to use a letter-of-credit for all direct HHS grants to that same recipient.

B. CASH MANAGEMENT

Cross-reference: Subpart H of 45 CFR Part 74

The standard for effective cash management which is discussed in 45 CFR 74.61(e) states that procedures must be established to minimize the time elapsing between the advance of grant or subgrant funds and their disbursement by the recipient. Grantees advancing cash to subgrantees must conform substantially to the same standards of timing and amount as apply to advances by HDS to grantees, including requirements for timely reporting of cash disbursements and cash balances.

Failure to adhere to these provisions may cause the unobligated portion of the letter-of-credit to be revoked or future advances to be discontinued.

Federal funds shall be promptly refunded to the Department and redrawn when needed if the funds are *erroneously* drawn in excess of immediate disbursement needs. The only exceptions to the requirement for prompt refunding are: (1) when the funds involved will be disbursed by the grantee within seven calendar days, or (2) are less than $10,000 and will be disbursed within 30 calendar days.

These exceptions to the requirement for prompt refunding shall not be construed as approval for a grantee to maintain excessive funds; rather, they are applicable only to excessive amounts of funds which are erroneously drawn.

1. Under Letter-of-Credit

Cash controls are essential in achieving the objective of the letter-of-credit system. Each recipient should develop these controls to meet its individual organizational pattern.

The system must provide that:

- The authorized signatory official in the organization is continually aware of the cash position of each letter-of-credit at the time vouchers are presented for payment.
- No withdrawn cash is applied toward any disbursement amount which exceeds the grantee's project or program authorized amount.
- Cash on hand for all programs combined is the minimum needed to cover immediate disbursements. This requires a system for matching the withdrawal pattern with the disbursement pattern.
- Total monthly withdrawals do not exceed the letter-of-credit (LOC) ceiling. When the letter-of-credit is based on a monthly ceiling, excess funds cannot be drawn in one month to cover disbursements in the following month as a means to overcome an inadequate ceiling.

2. Under Advances by Treasury Check

Cash management is equally important when advances are made by direct Treasury check, especially when such advances are prescheduled. It is the responsibility of the financial officer of the grantee organization to monitor drawdowns vs. disbursements, and to request adjustments in the schedule of advances, as appropriate. Additionally, the grantee's finance officer should assure that no withdrawn cash is applied toward any disbursement amount which exceeds the authorized amount in the approved budget.

3. Guidelines for Proper Cash Management

Suggestions for an effective cash management system may be found in Attachment D of this Manual.

C. FINANCIAL MANAGEMENT STANDARDS

Cross-reference: Subpart H of 45 CFR Part 74

The recipient' s policies and procedures describing its financial management system shall be in writing and conform to the standards for recipient financial management systems as prescribed in Subpart H of 45 CFR Part 74. Granting offices shall not impose additional standards on recipients unless specifically provided for in Subpart H of Part 74 or in a Federal statute; e.g., the Joint Funding Simplification Act (Pub. L. 93-510, as amended). However, suggestions and assistance may be provided in establishing or improving financial management systems when needed or requested.

Recipients shall meet the following standards for their grant and subgrant financial management systems:

Financial Reporting

Accurate, current, and complete disclosure of the financial results of each project or program shall be made in accordance with the financial reporting requirements of the grant or subgrant. The terms of grants and subgrants shall not require financial reporting on the accrual basis if the recipient's accounting system is maintained on the cash basis. When accrual reporting is statutorily required, a recipient whose accounting system is not maintained on that basis shall not be required to convert it to the accrual basis; the recipient may develop the accrual information through an analysis of the documentation on hand. The required financial reports should correspond to the recipient's accounting records.

Accounting Records

Records which identify adequately the source and application of funds for grant or subgrant-supported activities shall be maintained. These records shall contain information pertaining to grant or subgrant awards, authorizations, obligations, unobligated balances, assets, outlays, income, and, if the recipient is a government, liabilities. The records should also show the value of third-party in-kind contributions, in accordance with the requirements in Subpart G of 45 CFR Part 74. Suggestions for an effective accounting control system may be found in Attachment D of this Manual.

Internal Control

Effective control and accountability shall be maintained for all grant or subgrant cash, real and personal property covered by Subpart O of 45 CFR Part 74, and other assets. Recipients shall adequately safeguard all such property and shall assure that it is used solely for authorized purposes. For example, the recipient organization should, where possible, segregate responsibilities for receipt and custody of cash and other assets; maintaining accounting records on the assets; and authorizing transactions.

Budgetary Control

The actual and budgeted costs for each grant or subgrant shall be compared. If appropriate or specifically required, recipients shall relate financial information to performance or productivity data, including the production of unit cost information. If unit cost data are required, estimates based on available documentation will be accepted whenever possible. These comparisons should be used to: (1) avoid incurring obligations in excess of total funds authorized under an award, as well as the funds authorized for specific project activities and object class categories (to the extent restricted by the award); and (2) ensure prompt requests for granting office approval of budget revisions when necessary.

Suggestions for an effective budget control system may be found in Attachment D of this Manual.

Advance Payments

Cross-references:

- Subpart K of of 45 CFR Part 74 and
- "Cash Management" in Section B of this Chapter

Procedures shall be established to minimize the time elapsing between the advance of Federal grant or subgrant funds and their disbursement by the recipient.

Allowable Costs

Procedures shall be established for determining the reasonableness, allowability, and allocability of costs in accordance with the applicable cost principles prescribed by Subpart Q of 45 CFR Part 74 and the terms of the grant. The recipient's accounting system should identify and segregate unallowable costs.

Source Documentation

Accounting records shall be supported by source documentation such as cancelled checks, paid bills, payrolls, contract and subgrant award documents, etc. Documentation of the costs of Federal awards must support the costs charged to the awards as well as the costs used to meet cost-sharing or matching requirements. For example, documentation supporting third-party in-kind contributions should show the nature, value, dates of the contributions, and how the values were determined.

Audits

The financial management standards for audits are discussed in Chapter II of this Manual and §§74.61(h) and 74.62 of 45 CFR Part 74.

D. GRANT AND SUBGRANT-RELATED INCOME

Cross-reference: Subpart F of 45 CFR Part 74

Grant and subgrant-related income refers to: (1) interest and other investment income earned on advances of grant funds; and (2) program income. These categories of grant-related income are discussed below. The recipient is accountable to the granting office for any grant-related income.

1. Interest or Investment Income

Cross-reference: 45 CFR 74.47

a. General Discussion

Except where exempted by Federal statute (see next paragraph of this subsection for the principal exemption), grantees shall remit to HHS or HDS any interest or other investment income the grantee, subgrantee or a cost-type contractor earns on grant funds. This applies to: (1) advances of grant funds pending their disbursement for program purposes, and (2) grant funds no longer pending disbursement for program purposes, such as a refund due HHS resulting from a recovery from a third party. However, if, in accordance with HHS or HDS debt collection regulations or other policies, HHS charges interest on certain grant funds, the grantee need not pay any income earned on those funds in the period to which the charges apply.

Unless the grantee receives other remittance instructions from the responsible HDS official, the grantee shall remit the amount due by check or money order payable to HHS.

In accordance with the Intergovernmental Cooperation Act of 1968 (Pub. L. 90-577, as amended), States, as defined in the Act, shall not be accountable to the Federal Government for interest or investment income earned by the State itself, or by its subgrantees, where this income is attributable to grants-in-aid, as defined in the Act (42 U.S.C. 4213). "State" is defined in the Act to include agencies or instrumentalities of a State, but not political subdivisions of a State. The definition does not exclude a hospital or institution of higher education which is such an agency or instrumentality. "Grant-in-aid" is defined in the Act to exclude research and development grants.

A governmental grantee must qualify as a "State" or a subgrantee of a State grantee in order to qualify for this exception. All other grantees, including local governments and Federally-recognized Indian tribes, are subject to the general rule requiring the return of interest or other investment income earned on advances of grant funds.

Recipients are cautioned that they are subject to the provision in 45 CFR 74.61(e) for minimizing the time between the transfer of advances and their disbursement. Those provisions apply even if there is no accountability to the Federal Government for interest or other investment income earned on the advances.

b. Reporting

Interest earned on grant funds must be reported on the SF-272 or PMS-272, line 13.a, Federal Cash Transactions Report. (See Section A.3, Chapter 6.)

2. Program Income

a. General Discussion

Program income as defined in 45 CFR 74.41 means gross income earned by a recipient from activities, part or all of the cost of which is either borne as a direct cost by a grant or counted as a direct cost towards meeting a cost-sharing or matching requirement of a grant.

b. Examples of Program Income

- Fees for services provided (including voluntary payments for services provided)
- Sale of products/commodities/assets
- Usage or rental fees for space or equipment
- Copyright or patent royalties
- Publication sales
- License fees or permits

c. Examples which do not qualify as Program Income

- Revenues raised by a government recipient under its governing powers, such as taxes, special assessments, levies and fines, except as provided in 45 CFR 74.41(c) (1).
- Internal reimbursements or transfers of funds between organizational components of the same legal entity.
- Third-party in-kind contributions.
- Tuition and related fees received by an institution of higher education for a regularly offered course taught by an employee performing under a grant or subgrant.
- Credits, purchase discounts, rebates, allowances, adjustments for overpayments and other erroneous charges. These are considered "applicable credits" under the cost principles.
- Interest or other investment income earned from investing advances of Federal cash.
- Income earned from activities carried out by procurement contractors or subcontractors under a grant or subgrant.
- Gifts or financial assistance from another source such as: (1) a non-Federal grant; (2) charitable contributions (whether or not for a restricted purpose); and (3) another Federal grant.

d. Use of Program Income

Cross-reference: 45 CFR 74.42(b)

The recipient is accountable to the granting office for program income generated by HDS grant or subgrant-supported activities. All program income earned during the period of grant or subgrant support (except as provided under D.2.e below) shall be retained by the recipient and treated in accordance with one or a combination of the following options discussed in 45 CFR 74.42:

(1) Income is deducted from the total project costs and third-party in-kind contributions for the purpose of determining the amount to which the maximum Federal share percentage will be applied. Under this alternative, the recipient must use the income to reduce the amount of Federal and other funds needed to pay the allowable costs of the project. [See *deduction alternative* in 45 CFR 74.42(c).]

Income under this option, when received, must be used for current costs before grant funds. However, the HDS granting office may authorize carry over of income received by the recipient to the recipient's next funding period. If so, the recipient shall use the income carried over before it uses grant funds in that period.

(2) Income used for costs that count toward satisfying a cost-sharing or matching requirement. The income, when received, must be used to provide the cost-sharing or matching before grant funds are used. The carryover provisions of the deduction alternative also apply to this alternative. [See *cost-sharing or matching alternative* in 45 CFR 74.42(d).]

(3) Income is used by the recipient for costs that further the objectives of the statute under which the grant was made but which are not part of the project budget. They may be allowable or unallowable types of costs. Used in this fashion, income is not deducted from the total project costs when filling out the Financial Status Report and is not required to be used before grant funds; but, it does have to be reported. No authorization from the granting office is necessary if the income is to be used in a later period. [See *additional costs alternative* in 45 CFR 74.42(e).]

The additional costs alternative described in 45 CFR 74.42(e) may not be applied to program income earned by a recipient that is a for-profit organization.

A decision will be made at the time of grant award regarding the appropriate use of program income. The alternative selected will be expressly stated in the terms of the grant or subgrant award.

e. Special Treatment of Certain Types of Program Income

Copyright Royalties

The applicability of royalties and other income earned from a copyrighted work is discussed in 45 CFR 74.44. Income of this kind shall be retained by the recipient and used to further the objectives of the project under which the award was made, in accordance with the additional costs alternative in 45 CFR 74.42(e).

Patent or Invention Royalties

The disposition of royalties or equivalent income earned on patents or inventions arising out of activities is discussed in 45 CFR 74.45.

Sale of Real or Personal Property

See 45 CFR 74.43 for a discussion of the kinds of program income governed by Subpart O of Part 74.

Income Accrued After Grant or Subgrant Subpart

Program income accrued after the period of grant or subgrant support, as discussed in 45 CFR 74.46, shall be retained by the recipient and used to further the objectives of the project under which the award was made, in accordance with the "additional cost" alternative. [See 45 CFR 74.42(e).]

f. Records

Records of the receipt and disposition of program related income must be maintained by the recipient in the same manner as required for the funds provided by the grant or subgrant.

g. Reporting

Cross-reference: Chapter 6.2.A of this Manual

The following information pertaining to program income must be reported on the SF-269: (1) source (or how the income was earned); (2) amount; and (3) disposition (identify which alternatives the income was used under and how much for each). Specific instructions for reporting general program income earned on the Financial Status Report (SF-269) are as follows:

(1)Enter on line 10.c all general program income used during this period in accordance with the *deduction alternative.*

(2)Costs paid during the period by general program income under the *cost-sharing or matching alternative* (if permitted by the terms of the grant) must be included in line 10.f, and the amount of costs on that line paid by the income must be stated in item 12 (i.e., if any of the costs on line 10. f were paid by general program income, state the amount in item 12).

(3) The amount of costs paid during the period by general program income under the *additional costs alternative* (if permitted by the terms of the grant) must be stated in item 12 along with a description of the purposes for which the income was used.

(4) If any general program income is being held for use in a later period (to the extent such a deferral is authorized), state the amount in item 12.

(5) If any alternative besides the deduction alternative is permitted or if deferral to a later period is authorized, report the amount of general program income earned during the reporting period in item 12.

(6) In item 12 list the sources of the income earned during the reporting period or describe how the income was earned. If the sources or means are the same as those set forth in the application, state, "see application" in item 12.

(7) As a minimum, program income must be reported in a share proportionate to the direct costs charged to the program (or charged to the match) in connection with the generation of the income.

(8) Since interest earned is reported on the SF-272 or PMS-272, it is not necessary to report interest on the SF-269.

(9) If SF-270, Request for Advance or Reimbursement, is used to request cash, also report program income in item 11.b of this form.

(10) All program income required to be deducted must also be reported on the SF-272, line 11.g, Federal Cash Transactions Report.

E. REIMBURSEMENTS FROM OTHER FEDERAL AGENCIES

HDS encourages grantees to seek other Federal funds to supplement financial assistance provided by HDS grant funds. Grantees should anticipate the funding of these project costs by sources other than HDS and should not request funds from HDS to support these same activities.

F. FEDERAL TAXES

All recipients of HDS grant funds and their contractors are responsible for and must adhere to all applicable Federal income tax requirements.

Recipients that are political jurisdictions or separate public agencies are exempt from Federal income taxes and are not required to file any returns except for the employee withholding taxes. Recipients that are private, non-profit corporations similarly may qualify for exemption but must apply for exempt status (Internal Revenue Service Forms 1023 or 1024), obtain a written letter of authorization from IRS, and file annual information returns (Forms 990 or 990-A).

All recipients, other than political jurisdictions or separate public agencies, must also file information returns for each calendar year for certain payments (IRS Form 1099).

Other forms used by recipients are IRS Form 940, "Employers Annual Federal Unemployment Tax Form" and IRS Form 941, "Employers Quarterly Federal Tax Return." Questions concerning the applicability of these requirements to grant funds may be directed to the Internal Revenue Service.

G. CASH DEPOSITORIES

Requirements governing cash depositories are discussed in Subpart B of Part 74. Consistent with the national goal of expanding opportunities for minority business enterprise, recipients are encouraged to use minority-owned banks. A list of minority-owned banks may be obtained from the:

Department of Health and Human Services
Office of Procurement, Assistance and Logistics
200 Independence Avenue, S.W.
Room 517 "D"
Hubert H. Humphrey Building
Washington, D.C. 20201

H. BONDING

Bonding requirements are discussed in Subpart C of Part 74.

I. INSURANCE

1. General Discussion

Unless the organization receives Head Start funds, the recipient shall observe its regular requirements and practices with respect to insurance.

2. Insurance Requirements for Head Start Grantees

a. General

In accordance with the requirements of 45 CFR 1301.11, private nonprofit Head Start grantees and their delegate agencies shall be covered by reasonable amounts of student accident insurance, by liability insurance for accidents on the agencies' premises, and by transportation liability insurance. With respect to local public agencies, insurance coverage that is required by local government is sufficient.

Student accident insurance shall cover medical costs and death benefits for accidents during program hours and periods immediately preceding and following program hours. It shall also cover official activities, such as field trips away from agency premises and at times other than program hours.

Liability insurance shall cover the agency and staff for liability for accidents to children, staff, volunteers, parents and visitors on the agency's premises. There shall be reasonable transportation liability insurance covering the agency, owners, and drivers of all vehicles utilized for the provision of transportation services. Transportation liability insurance, including collision, in connection with a Head Start program, is an allowable cost. Guidance on rate structures is included in *New Insurance Programs for Human Service Transportation Providers - Technical Advisory No. 1,* dated August 1979 which is available from insurance providers or the state insurance office.

b. Limitations of Coverage and Selection of Carrier

The amount of liability coverage carried by a private nonprofit Head Start recipient may vary depending upon the number of children served and the types of services provided. Grantees and delegate agencies are encouraged to avail themselves of the services of an independent insurance agent or broker for advice and assistance in obtaining the proper coverage. Grantees must comply with all applicable State and local insurance requirements.

CHAPTER 5

Administrative Requirements

A. GENERAL DISCUSSION

Cross-reference: 45 CFR 74.7

In accepting a grant, the grantee agrees to administer the project in accordance with the HHS and HDS regulations and policies in effect at the time of award. The grantee is accountable for the fiscal and administrative management of the grant and completion of any special conditions prescribed for the conduct of the project. As provided in 45 CFR 74.7, special grant conditions more restrictive than those prescribed in Part 74 may be imposed as needed when the granting office has determined that the grantee:

- Is financially unstable;
- Has a history of poor performance; or
- Has a management system which does not meet the standards of Part 74.

Grantees may apply the provisions in §74.7 to their subgrantees. Whenever they do so, a copy of the notice to the subgrantee shall be furnished to the HDS granting office. Additional information regarding special conditions is provided in §74.7 of 45 CFR Part 74.

B. PERSONNEL ADMINISTRATION

1. Requirement

Grantees shall develop and maintain a suitable personnel management system.

2. Guidelines

Suggestions and guidelines for an effective recipient personnel management system are in Appendix D of this Manual.

3. Documentation

The grantee's personnel policies and procedures shall be documented in writing and issued to, or made available to, all grantee employees. The personnel policies must be approved by the governing body or person authorized to act on behalf of the grantee organization.

4. Conflict of Interest and Nepotism

Recipients shall establish safeguards to prohibit employees from using their positions for a purpose that is or gives the appearance of being motivated by a desire for private gain for themselves or others, particularly those with whom they have family, business, or other ties. [See Part V of the standard application form.]

To preclude potential conflict of interest, organizations receiving HDS grant support should have written guides for employees indicating the conditions under which outside activities, relationships, or financial interest are proper or improper and provide that potential conflicts of interest are reported to the responsible recipient official.

The recipient's personnel policies shall prohibit the hiring of any individual if a member of that individual's immediate family is employed in an administrative capacity in the agency or is a member of the governing board. The term "immediate family" means wife, husband, son, daughter, mother, father, brother, sister, or relative by marriage of comparable degree; the term "administrative capacity" means a position having responsibilities relating to the selection, hiring, or supervising of employees. When a recipient organization cannot adequately staff positions without hiring such an individual, the recipient may deviate from this policy. However, employment records must provide evidence that no other individual within the service area is qualified and available for the employment.

5. Code of Conduct

As specified in Chapter 8 of this Manual, grantees shall maintain a written code of conduct which governs the performance of their employees engaged in the award/administration of procurement contracts supported by Federal funds.

6. Political Activity

Cross-reference: Chapter 7 of this Manual

If an organization is covered by the Hatch Act which prescribes permitted and prohibited political activities, the personnel policies must incorporate the provisions of the Act.

C. USE OF CONSULTANTS

1. General Discussion

Recipients and their contractors are expected to carry out project activities by using the services of personnel receiving salary support under the grant, subgrant, or cost-type contract. HDS recognizes, however, that some efforts undertaken in connection with a project make it necessary for organizations to use consultants to accomplish the project objectives.

HDS expects applicants to anticipate their need for consultants and to describe in their applications how consultants will be used. However, prior approval for the use of consultants is not required unless the consulting arrangement involves a transfer of substantive programmatic work to another party as discussed in Section K, Chapter I of this Manual.

2. Consultants: Use of an Organization's Own Employees

a. Faculty Members of Educational Institutions

Charges representing extra compensation (above base salary) paid by an educational institution to a salaried member of its faculty for consulting work are allowable only in unusual cases, and only if the following conditions exist (see Section J.6.e of OMB Circular A-21, the cost principles for educational institutions):

(1) The consultation is across departmental lines or involves a separate or remote operation;

(2) The work performed is in addition to the faculty member's regular departmental load; and

(3) Such consulting arrangements are specifically provided for in the grant or approved in writing by the granting office.

b. All other cases

In all other cases, consulting fees paid in addition to salary by recipients or cost-type contractors to people who are also their employees may be charged to an HDS grant, subgrant, or cost-type contract only in unusual cases, and only if all of the following three conditions exist:

(1) The policies of the recipient or contractor permit such consulting fee payments to its own employees regardless of whether Federal grant funds are involved; and

(2) The work involved is clearly outside the scope of the person's salaried employment; and

(3) It would be inappropriate or not feasible to compensate for the additional work by paying additional salary to the employee.

c. Requirements for Approval

Consulting fees paid by an organization to its employees must have specific prior approval in writing from the head of the recipient or contractor or from his or her designated representative. If the recipient or contractor is a government, the approval may be given by the head (or a designated representative of the head) of the government's agency which is primarily responsible for administering or carrying out the project or program. If the designated

representative is personally involved in the project or program under consideration, the approval may be given only by the head. If the head is personally involved in the project or program under consideration, prior approval from the granting office is required. Each prior approval must include a determination that the applicable requirements in subsection 2 above are present.

3. Documentation Standards

Charges for consulting payments must be supported in the records of the recipient or cost-type contractor by an invoice from the consultant and a copy of the written report (if a report is appropriate) received from the consultant. If any of the following information is not shown on the invoice and/or report from the consultant, the information must be shown in a memorandum or other document prepared by the recipient or contractor for its files, or noted in handwriting on the consultant' s invoice by the recipient or contractor. The memorandum, other document, or handwritten notation must be signed by an official of the recipient or contractor.

- the name of the consultant;
- the nature of the services rendered;,
- the relevance of the services to the project if not apparent from the nature of the services; and
- whichever of the following is applicable:

(1) (if the fee was based on a rate per day or hour worked), the rate and the dates and/or hours worked; or

(2) (if the fee was based on a rate per unit of service rendered), the rate, the number of units of service rendered, and the beginning and ending dates of the overall period of service; or

(3) (if the fee was determined on some other basis) the basis for determining the fee and the beginning and ending dates of the period in which services were rendered.

D. RETENTION AND ACCESS REQUIREMENTS FOR RECORDS

Cross-reference: Subpart D of 45 CFR Part 74

1. General Discussion

The requirements for retention and access to financial and programmatic records, statistical records, supporting docucents, and all other records pertaining to a grant-supported project or required to be maintained by the terms of an HDS grant are discussed in Subpart D of Part 74.

2. Freedom of Information Act

The Supreme Court has ruled that the Freedom of Information Act does not apply to the records of recipients, unless obtained by the Federal granting agency (*Forsham v. Harris*, 100 S. ct. 978 (1980)).

E. ACKNOWLEDGMENTS OF SUPPORT ON PUBLICATIONS AND AUDIOVISUALS

1. Publications

Recipient project directors are encouraged to make the results and accomplishments of their activities available to the public. Recipients shall have an acknowledgment of HDS support placed on any publication written or published with grant support and, if feasible, on any publication reporting the results of, or describing, a grant-supported activity.

2. Audiovisuals

Recipients shall have an acknowledgment of HDS support placed on any audiovisual which is produced with grant support and which has a direct production cost to the recipient of over $20,000. [See Chapter 1, Section L for a discussion of prior approval requirements for audiovisuals.] Unless the terms of the grant make it apply, this requirement does not apply to audiovisuals produced as research instruments or for documenting experimentation or findings and which are not intended for presentation or dissemination to the general public.

3. How to Word an Acknowledgment of Support

The words "sponsored by" or "produced for" or their equivalents do not correctly express the grant relationship and must not be used.

Examples of expressing an acknowledgment of support are:

- "This publication was made possible by a grant from....."
- "The project described in this article was supported by a grant from....."
- "Funding for this program was provided in part by....."

4. Disclaimers

The acknowledgment must not represent or suggest in any way that the views expressed are those of the Federal Government. For audiovisuals covered under E.2 above, the acknowledgment must include the following explicit statement or its equivalent, except if clearly unnecessary or inappropriate because of the nature of the subject matter:

> "The opinions expressed in this (*film, program, etc.*) do not necessarily reflect the views of (*name of the HDS granting office)*"

Unless waived by the HDS granting office, this acknowledgment must also include the following statement or its equivalent:

> "The *(name of HDS granting office)* has not approved this (*film, program, etc.*) for presentation to the general public."

F. SURVEYS AND QUESTIONNAIRES

Whenever an HDS granting office sponsors the use by a grantee of a reporting form to collect identical information from ten or more sources outside the Federal Government, the grantee must obtain, through the HDS Project Officer, the required Office of Management and Budget clearance in accordance with OMB Circular A-40, before making public contacts for the collection of data. A report form or "plan" used by a recipient of an HDS program grant is considered to be sponsored by HDS when:

- The recipient of a grant uses the report form or "plan" to collect information that the responsible HDS granting office has requested for the planning, operation or evaluation of its grant project; or
- The terms and conditions of the grant provide for approval by the granting office of the survey design, questionnaire content or data collection procedure; or,
- The terms and conditions of the grant provide for submission of data to the HDS granting office received from individual respondents and/or special tabulations relative to the data.

Grantees collecting information may not represent to their respondents that the information is being collected for or in association with HDS unless the responsible HDS granting office has determined that such a representation would be true in the particular case and has authorized the grantee in writing to make the representation in suitably qualified form. Such acknowledgments are encouraged but not required.

CHAPTER 6
Reports

A. FINANCIAL REPORTING REQUIREMENTS

Cross-reference: Subpart I of Part 74

1. General Discussion

Grantees are required to use certain specified forms to report financial information to HDS. General requirements for financial reporting are discussed in 45 CFR 74.72.

2. Financial Status Report

Cross-references:
- 45 CFR 74.73;
- Exhibit X-6-1 of this Chapter;
- Chapter 1.I.3 of this Manual;
- Chapter 1.L.3 of this Manual; and
- Chapter 4.D.2.g of this Manual

All HDS grantees shall use SF-269, "Financial Status Report" (or computer printouts with required information) to report the status of funds for all nonconstruction grants. Each grantee shall report program outlays and program income on the same accounting basis, i.e., cash or accrual, which it uses in its accounting system. Information reported must be reconcilable to the grantee organization's books of account. Financial data must be provided in the vertical columns (a) through (f) of the SF-269 for each grant function, activity, or program account in the budget. HDS will provide instructions to the grantee regarding the frequency of financial report submission. However, the report shall not be required more frequently than quarterly except as provided in §§74.7 and 74.72(e) of Part 74. If the HDS granting office does not specify the frequency of the report, it shall be submitted annually. A final report shall be required upon expiration or termination of grant support.

When reports are required on a quarterly or semiannual basis, they shall be due 30 days after the reporting period. When required on an annual basis, they shall be due 90 days after the end of the reporting period. Final reports shall be due ninety (90) days after the expiration or termination of grant support. Unless otherwise instructed by the HDS Grants Officer, final reports are due 90 days after the end of each budget period for grantees with "indefinite" project periods (e.g., Head Start).

In unusual circumstances, the deadline date for submitting a final report may be extended for a reasonable time period if requested in writing and approved by the Grants Officer. Failure to submit a final report within a reasonable period of time would be considered an example of poor financial management and taken into account when the fiscal performance of the grantee is evaluated. A resultant poor evaluation could result in a denial or delay in refunding, grounds for tighter fiscal controls on other HDS grants, or other appropriate action.

Each financial report submitted by the grantee must reflect the proper amount of indirect costs applicable to the grant based on the most current rate(s) available at the time the report is submitted. If a provisional rate is used in the report, a subsequent adjustment will be necessary when a permanent rate applicable to the grant is established. [See discussion of indirect costs in Chapter 3.B of this Manual.]

Grantees shall use the "Remarks" Section (Item 12) of this report to identify any reimbursements received during the period from other Federal agencies for grant-supported activities. This information shall include the amount of funds received and the source. If such funds replace HDS grant funds originally budgeted for the same purpose, they shall also be included in Item 10-m of the report.

Program income earned during the period shall also be reported on the SF-269 in accordance with the instructions specified in Chapter 4.D.2.g of this Manual.

3. Federal Cash Transactions Report

Cross-references:
- 45 CFR 74.72;
- Chapter 4.D.1 of this Manual; and
- Exhibits X-6-2 of this Chapter

The "Federal Cash Transactions Report" (SF-272) is used to monitor cash advanced to grantees and to obtain disbursement or outlay information from grantees paid through either the Division of Accounting Operations (DAO) or the Regional Administrative Support Center (RASC). The Federal Cash Transactions Report is closely monitored by HDS grants management staff and the finance office to determine what cash balance and cash deficits the grantee maintains. Information contained on the Cash Transactions Report must be reconcilable to the grantee's books of account.

Interest earned on grant funds shall be reported on the SF-272, line 13.a, in accordance with the instructions provided in Chapter 4.D.1.b of this Manual. Program income required to be deducted shall be reported on line 11.g of the SF-272. [See Chapter 4.D.2.g.] The SF-272 is submitted in addition to the Financial Status Report (SF-269). Grantees shall submit the report no later than 15 working days following the end of each quarter, unless otherwise instructed by the HDS Grants Officer.

4. Grantee Report of Expenditures/Federal Cash Transactions Report

Cross-references:.
- 45 CFR 74.74 and
- Exhibit X-6-3 of this Chapter

All grantees paid through the Payment Management System (PMS) must submit the PMS-272 on either a monthly basis or quarterly basis (as determined by PMS). This report is in addition to the Financial Status Report (SF-269) submitted to the HDS granting office. Amounts represented on the final PMS-272 must be identical to those represented on the final SF-269. Interest and program income must be reported on the PMS-272 in accordance with the instructions provided in Chapter 4.D of this Manual.

5. Request for Advance or Reimbursement

Cross-references:
- 45 CFR 74.75 and
- Exhibits X-6-4a and X-6-4b of this Chapter

HDS uses either Standard Form 270 or PMS-270, "Request for Advance or Reimbursement" when (1) advance payments by Treasury check are not made for a nonconstruction grant on a predetermined basis; (2) a grantee is paid by reimbursement for a nonconstruction grant; or (3) a grantee is paid by advance or reimbursement for a construction grant. The frequency for submitting payment requests is discussed in 45 CFR 74.96 and Chapter 4.A of this Manual.

B. PERFORMANCE OR PROGRESS REPORTING REQUIREMENTS

Cross-reference: Subpart J of Part 74

Recipients are responsible for monitoring and reporting program performance to assure that adequate progress is being made toward achieving the objectives of the grant or subgrant program or activities.

Most HDS granting offices provide specific instructions for the completion of the performance report either in program regulations or guidelines. In some cases, more specific information to be included in these reports may be determined and agreed upon by the HDS granting office and the grantee at the time the grant is awarded. Depending on the grant award terms and conditions, a performance report is generally submitted with the Financial Status Report to the appropriate HDS Grants Officer. The granting office may, however, waive the requirement for any performance report which is not needed. [See 45 CFR 74.82(a).]

Monitoring and reporting of program performance is further discussed in Subpart J of Part 74.

C. OVERDUE REPORTS

It is HDS policy that administrative action be taken in discretionary grant programs to obtain overdue reports (either current reports or reports from a prior funding period) from grantees as indicated below. The term "reports" is meant to include financial, performance or other reports required by the HDS granting office.

1. Action on Overdue Financial Reports

Following reasonable notice to the grantee, the payment office shall make no further payments to the grantee until:

- The overdue report is received;
- The reporting requirement is waived; or
- A new due date is set.

The only acceptable reasons for waiving the reporting requirement or setting a new due date are that either the report cannot be submitted in a timely manner for reasons over which the grantee has no control or the purposes for which the report is to be used will be accomplished through other means.

2. Action on All Other Overdue Reports

a. *First letter*: The cognizant HDS Grants Officer, in coordination with the Federal Project Officer in the HDS granting office, will send a delinquency notification letter to the grantee requesting the report. The grantee shall submit the report or explain the reasons for not sending it within 30 days of the date of the Grants Officer's letter.

b. *Second letter*: If neither the report nor an acceptable explanation is received, the HDS Grants Officer will send a follow-up letter to the grantee stating that the report must be received within thirty (30) days and failure to do so may result in:

(1) Suspension or termination of the grant;

(2) Withholding of any additional awards; or

(3) Additional and more severe action.

c. *Fund Cutoff*: If neither the report nor an acceptable explanation is received by the HDS Grants Officer within 30 days of the second letter, no additional funds shall be awarded for the project while the report remains overdue and the grant, if still active, shall be suspended. The HDS Grants Officer, in coordination with the HDS granting office's Federal Project Officer, will set a final date by which the report must be received. If the report or an acceptable explanation is not received by that date, the grant shall be terminated.

d. *Exception - Prompt Suspension or Termination:* A notice of suspension or termination may be issued as soon as the report becomes overdue if failure to submit the report on time constitutes a material violation of grant terms and prompt suspension or termination is necessary to protect the Federal government's interest.

e. *Waivers and Extensions*: If at any time the grantee does provide an acceptable explanation why the overdue report cannot be submitted promptly, the reporting requirement shall be waived or a new due date set. Further extensions of the due date will also be given, if justified.

3. Additional Actions

The HDS Grants Officer, in coordination with the HDS granting office's Federal Project Officer, may take any of the following additional actions when a grantee is delinquent in submitting a report:

(1) Withholding further grant payments;

(2) Converting to the reimbursement method of paying the grantee;

(3) Withholding any additional awards otherwise approved and pending for the specific project;

(4) Requesting a special audit by the HHS Office of Audit;

(5) Notifying other Federal granting agencies of the delinquency so that precautionary measures may be taken;

(6) Awarding no discretionary grant funds while the report is overdue for some or all of the other report eligible HDS projects conducted by the grantee organization; or

(7) Considering legal action with the HHS Office of General Counsel.

FINANCIAL STATUS REPORT

(Follow instructions on the back)

1. FEDERAL AGENCY AND ORGANIZATIONAL ELEMENT TO WHICH REPORT IS SUBMITTED		2. FEDERAL GRANT OR OTHER IDENTIFYING NUMBER	OMB Approved No. 80-R0180	PAGE OF PAGES
3. RECIPIENT ORGANIZATION (Name and complete address, including ZIP code)	4. EMPLOYER IDENTIFICATION NUMBER	5. RECIPIENT ACCOUNT NUMBER OR IDENTIFYING NUMBER	6. FINAL REPORT ☐ YES ☐ NO	7. BASIS ☐ CASH ☐ ACCRUAL
	8. PROJECT/GRANT PERIOD (See instructions) FROM (Month, day, year)	TO (Month, day, year)	9. PERIOD COVERED BY THIS REPORT FROM (Month, day, year)	TO (Month, day, year)

10. STATUS OF FUNDS

PROGRAMS/FUNCTIONS/ACTIVITIES ▶	(a)	(b)	(c)	(d)	(e)	(f)	TOTAL (g)
a. Net outlays previously reported	$	$	$	$	$	$	$
b. Total outlays this report period							
c. *Less:* Program income credits							
d. Net outlays this report period (*Line b minus line c*)							
e. Net outlays to date (*Line a plus line d*)							
f. *Less:* Non-Federal share of outlays							
g. Total Federal share of outlays (*Line e minus line f*)							
h. Total unliquidated obligations							
i. *Less:* Non-Federal share of unliquidated obligations shown on line h							
j. Federal share of unliquidated obligations							
k. Total Federal share of outlays and unliquidated obligations							
l. Total cumulative amount of Federal funds authorized							
m. Unobligated balance of Federal funds							

11. INDIRECT EXPENSE

a. TYPE OF RATE (Place "X" in appropriate box) ☐ PROVISIONAL ☐ PREDETERMINED ☐ FINAL ☐ FIXED			
b. RATE	c. BASE	d. TOTAL AMOUNT	e. FEDERAL SHARE

12. REMARKS: Attach any explanations deemed necessary or information required by Federal sponsoring agency in compliance with governing legislation.

13. CERTIFICATION

I certify to the best of my knowledge and belief that this report is correct and complete and that all outlays and unliquidated obligations are for the purposes set forth in the award documents.

SIGNATURE OF AUTHORIZED CERTIFYING OFFICIAL	DATE REPORT SUBMITTED
TYPED OR PRINTED NAME AND TITLE	TELEPHONE (Area code, number and extension)

269-101

STANDARD FORM 269 (7-76)
Prescribed by Office of Management and Budget
Cir. No. A-110

INSTRUCTIONS

Please type or print legibly. Items 1, 2, 3, 6, 7, 9, 10d, 10e, 10g, 10i, 10l, 11a, and 12 are self-explanatory, specific instructions for other items are as follows:

Item	Entry
4	Enter the employer identification number assigned by the U.S. Internal Revenue Service or FICE (institution) code, if required by the Federal sponsoring agency.
5	This space is reserved for an account number or other identifying numbers that may be assigned by the recipient.
8	Enter the month, day, and year of the beginning and ending of this project period. For formula grants that are not awarded on a project basis, show the grant period.
10	The purpose of vertical columns (a) through (f) is to provide financial data for each program, function, and activity in the budget as approved by the Federal sponsoring agency. If additional columns are needed, use as many additional forms as needed and indicate page number in space provided in upper right; however, the totals of all programs, functions or activities should be shown in column (g) of the first page. For agreements pertaining to several Catalog of Federal Domestic Assistance programs that do not require a further functional or activity classification breakdown, enter under columns (a) through (f) the title of the program. For grants or other assistance agreements containing multiple programs where one or more programs require a further breakdown by function or activity, use a separate form for each program showing the applicable functions or activities in the separate columns. For grants or other assistance agreements containing several functions or activities which are funded from several programs, prepare a separate form for each activity or function when requested by the Federal sponsoring agency.
10a	Enter the net outlay. This amount should be the same as the amount reported in Line 10e of the last report. If there has been an adjustment to the amount shown previously, please attach explanation. Show zero if this is the initial report.
10b	Enter the total gross program outlays (less rebates, refunds, and other discounts) for this report period, including disbursements of cash realized as program income. For reports that are prepared on a cash basis, outlays are the sum of actual cash disbursements for goods and services, the amount of indirect expense charged, the value of in-kind contributions applied, and the amount of cash advances and payments made to contractors and subgrantees. For reports prepared on an accrued expenditure basis, outlays are the sum of actual cash disbursements, the amount of indirect expense incurred, the value of in-kind contributions applied, and the net increase (or decrease) in the amounts owed by the recipient for goods and other property received and for services performed by employees, contractors, subgrantees, and other payees.
10c	Enter the amount of all program income realized in this period that is required by the terms and conditions of the Federal award to be deducted from total project costs. For reports prepared on a cash basis, enter the amount of cash income received during the reporting period. For reports prepared on an accrual basis, enter the amount of income earned since the beginning of the reporting period. When the terms or conditions allow program income to be added to the total award, explain in remarks, the source, amount and disposition of the income.
10f	Enter amount pertaining to the non-Federal share of program outlays included in the amount on line e.
10h	Enter total amount of unliquidated obligations for this project or program, including unliquidated obligations to subgrantees and contractors. Unliquidated obligations are: Cash basis—obligations incurred but not paid; Accrued expenditure basis—obligations incurred but for which an outlay has not been recorded. Do not include any amounts that have been included on lines a through g. On the final report, line h should have a zero balance.
10j	Enter the Federal share of unliquidated obligations shown on line h. The amount shown on this line should be the difference between the amounts on lines h and i.
10k	Enter the sum of the amounts shown on lines g and j. If the report is final the report should not contain any unliquidated obligations.
10m	Enter the unobligated balance of Federal funds. This amount should be the difference between lines k and l.
11b	Enter rate in effect during the reporting period.
11c	Enter amount of the base to which the rate was applied.
11d	Enter total amount of indirect cost charged during the report period.
11e	Enter amount of the Federal share charged during the report period. If more than one rate was applied during the project period, include a separate schedule showing bases against which the indirect cost rates were applied, the respective indirect rates the month, day, and year the indirect rates were in effect, amounts of indirect expense charged to the project, and the Federal share of indirect expense charged to the project to date.

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GPO 917-948

FEDERAL CASH TRANSACTIONS REPORT

(See instructions on the back. If report is for more than one grant or assistance agreement, attach completed Standard Form 272-A.)

Approved by Office of Management and Budget, No. 80-R0182

1. Federal sponsoring agency and organizational element to which this report is submitted

2. RECIPIENT ORGANIZATION

Name :

Number and Street :

City, State and ZIP Code:

3. FEDERAL EMPLOYER IDENTIFICATION NO. ▶

4. Federal grant or other identification number

5. Recipient's account number or identifying number

6. Letter of credit number

7. Last payment voucher number

Give total number for this period

8. Payment Vouchers credited to your account

9. Treasury checks received (whether or not deposited)

10. PERIOD COVERED BY THIS REPORT

FROM (month, day, year) TO (month, day year)

11. STATUS OF FEDERAL CASH *(See specific instructions on the back)*		
	a. Cash on hand beginning of reporting period	$
	b. Letter of credit withdrawals	
	c. Treasury check payments	
	d. Total receipts (*Sum of lines b and c*)	
	e. Total cash available (*Sum of lines a and d*)	
	f. Gross disbursements	
	g. Federal share of program income	
	h. Net disbursements (*Line f minus line g*)	
	i. Adjustments of prior periods	
	j. Cash on hand end of period	$

12. THE AMOUNT SHOWN ON LINE 11J, ABOVE, REPRESENTS CASH REQUIREMENTS FOR THE ENSUING *Days*	13. OTHER INFORMATION	
	a. Interest income	$
	b. Advances to subgrantees or subcontractors	$

14. REMARKS (*Attach additional sheets of plain paper, if more space is required*)

15. CERTIFICATION

I certify to the best of my knowledge and belief that this report is true in all respects and that all disbursements have been made for the purpose and conditions of the grant or agreement

AUTHORIZED CERTIFYING OFFICIAL

SIGNATURE

DATE REPORT SUBMITTED

TYPED OR PRINTED NAME AND TITLE

TELEPHONE (*Area Code*) (*Number*) (*Extension*)

THIS SPACE FOR AGENCY USE

272-101

STANDARD FORM 272 (7-76)
Prescribed by Office of Management and Budget
Cir. No. A-110

INSTRUCTIONS

Please type or print legibly. Items 1, 2, 8, 9, 10, 11d, 11e, 11h, and 15 are self explanatory, specific instructions for other items are as follows:

Item	*Entry*
3	Enter employer identification number assigned by the U.S. Internal Revenue Service or the FICE (institution) code. If this report covers more than one grant or other agreement, leave items 4 and 5 blank and provide the information on Standard Form 272–A, Report of Federal Cash Transactions—Continued; otherwise;
4	Enter Federal grant number, agreement number, or other identifying numbers if requested by sponsoring agency.
5	This space reserved for an account number or other identifying number that may be assigned by the recipient.
6	Enter the letter of credit number that applies to this report. If all advances were made by Treasury check, enter "NA" for not applicable and leave items 7 and 8 blank.
7	Enter the voucher number of the last letter-of-credit payment voucher (Form TUS 5401) that was credited to your account.
11a	Enter the total amount of Federal cash on hand at the beginning of the reporting period including all of the Federal funds on deposit, imprest funds, and undeposited Treasury checks.
11b	Enter total amount of Federal funds received through payment vouchers (Form TUS 5401) that were credited to your account during the reporting period.
11c	Enter the total amount of all Federal funds received during the reporting period through Treasury checks, whether or not deposited.
11f	Enter the total Federal cash disbursements, made during the reporting period, including cash received as program income. Disbursements as used here also include the amount of advances and payments less refunds to subgrantees or contractors, the gross amount of direct salaries and wages, including the employee's share of benefits if treated as a direct cost, interdepartmental charges for supplies and services, and the amount to which the recipient is entitled for indirect costs.
11g	Enter the Federal share of program income that was required to be used on the project or program by the terms of the grant or agreement.
11i	Enter the amount of all adjustments pertaining to prior periods affecting the ending balance that have not been included in any lines above. Identify each grant or agreement for which adjustment was made, and enter an explanation for each adjustment under "Remarks." Use plain sheets of paper if additional space is required.
11j	Enter the total amount of Federal cash on hand at the end of the reporting period. This amount should include all funds on deposit, imprest funds, and undeposited funds (line e, less line h, plus or minus line i).
12	Enter the estimated number of days until the cash on hand, shown on line 11j, will be expended. If more than three days cash reqirements are on hand, provide an explanation under "Remarks" as to why the drawdown was made prematurely, or other reasons for the excess cash. The requirement for the explanation does not apply to prescheduled or automatic advances.
13a	Enter the amount of interest earned on advances of Federal funds but not remitted to the Federal agency. If this includes any amount earned and not remitted to the Federal sponsoring agency for over 60 days, explain under "Remarks." Do not report interest earned on advances to States.
13b	Enter amount of advance to secondary recipients included in item 11h.
14	In addition to providing explanations as required above, give additional explanation deemed necessary by the recipient and for information required by the Federal sponsoring agency in compliance with governing legislation. Use plain sheets of paper if additional space is required.

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HDS/GAM TN 86-1

PMS 272

FEDERAL CASH TRANSACTIONS REPORT
STATUS OF FEDERAL CASH

OMB NO. 0990-0078
(APPROVAL THROUGH 9/30/84)

GIVEN FEDERAL ASSISTANCE RECIPIENT ORGANIZATION CO. INC.
NUMBER 23456 MAIN STREET
ANYPLACE MD 20852-1234
PAN: A123G EIN: 123456789
LOC-FRB REGION: 03 STATE: MD

PERIOD COVERED BY THIS REPORT:
04/01/82 - 06/30/82

GENERAL ACCOUNT

1.	CASH ON HAND BEGINNING OF REPORTING PERIOD		$ 18,157.00
2.	TOTAL RECEIPTS (SEE STATEMENT OF CASH ACCOUNTABILITY FOR DETAILS)	+	14,333.00
3.	TOTAL CASH AVAILABLE		$ 32,490.00
4.	NET DISBURSEMENTS (FROM PMS 272-A)	-	
5.	ADJUSTMENTS OF PRIOR PERIODS (SEE STATEMENT OF CASH ACCOUNTABILITY FOR DETAILS)	+	5,930.00
6.	CASH ON HAND END OF PERIOD (line 3, less line 4, plus or minus line 5)		$

7. THE AMOUNT SHOWN ON LINE 6, ABOVE, REPRESENTS CASH REQUIREMENTS FOR THE ENSUING _____ DAYS
(NUMBER)

6-9

OTHER INFORMATION

8.	INTEREST INCOME	$
9.	ADVANCES TO SUBGRANTEES OR SUBCONTRACTORS	$

AUTHORIZED CERTIFYING OFFICIAL

I CERTIFY TO THE BEST OF MY KNOWLEDGE AND BELIEF THAT THIS REPORT IS TRUE IN ALL RESPECTS AND THAT ALL DISBURSEMENTS HAVE BEEN MADE FOR THE PURPOSE AND CONDITIONS OF THE GRANT OR AGREEMENT.

SIGNATURE _____ DATE REPORT SUBMITTED _____

TYPED OR PRINTED NAME AND TITLE _____

TELEPHONE: (Area Code) _____ (Number) _____ (Extension) _____

********************WARNING********************
* You have drawn $366,400.00 (91.6%) of your current annual letter-of-credit ceiling of $400,000 thru *
* June 30, 1982 (75% of the year). You may wish to contact your PMS representative listed below to *
* request an adjustment to this ceiling. *
****

PMS 272-A (A) FEDERAL CASH TRANSACTIONS REPORT (CONTINUATION) PAGE 2
HHS - PMS

GIVEN FEDERAL ASSISTANCE RECIPIENT ORGANIZATION CO. INC.
PAN: A123G EIN: 123456789
LOC-FRB REGION: 03 STATE: MD

PERIOD COVERED BY THIS REPORT:
04/01/82 - 06/30/82
GENERAL ACCOUNT

REPORT LINE ITEM	(F) FEDERAL GRANT OR OTHER IDENTIFICATION (a)	RECIP A/C OR OTHER ID NO (b)	(C) AUTHORIZED AMOUNT (c)	(D) FEDERAL SHARE OF NET DISBURSEMENTS CUM THRU 03/31/82 (d)	(E) CUM THRU 06/30/82 (e)
0001 @	D-G007904144	000000000708	102,017	23,600.00	
0002 @	2-G007701152	000000000639	324,649	324,100.00	
0003	3-01H000360A		891,525	0.00	
0004	8-R01CA00900-0103	000000000701	9,440	9,440.00	
AWARD CHG: 3R01CA00900-03S3A3 ON 5/24/82 $(560)					
0005	8-R01CA00900-0405	000000000703	84,995	75,098.21	
0006	7-01P000143A	00000000A011	495,400	0.00	
0007	9-01H000141A	00000000C108	106,090	13,000.00	
(2)	SUBTOTAL		2,014,116	445,238.21	

(3) PLEASE ENTER DOCUMENTS MISSING FROM ABOVE (COPY OF AWARD DOCUMENT MUST BE ATTACHED):

(4A)	(4B)	(4C)	(4D)	(4E)
TOTALS			(5D)	(5E)

NET DISBURSEMENTS (column e minus column d) MUST CORRESPOND WITH AMOUNT SHOWN ON PMS 272 LINE 4 (6F)

LINE	Resolution of previously reported award problems:			Msg No.	Brief Description
	THE FOLLOWING AWARD(S) REPORTED MISSING OR FOR WRONG AMOUNTS ON AN EARLIER PMS 272 HAVE BEEN ACCEPTED:				
	2-G0077001152	000000000639	549	...(M01)	INCLUDED IN REPORT LINE ITEM 0002, ABOVE
0009	9-01H000141A	00000000C108	106,090	...(M03)	CONFIRMED-AWAITING DATA FROM OPDIV-IS LINE 0007 ABOVE
	7-01P000143A	00000000A011	495,400	...(M04)	ACCEPTED
	8-R01CA00900-0405	000000000703	10	...(M05)	ACCEPTED, CHANGED AMOUNT
(7)	3-01H000360A		891,525	...(M06)	NOT YET CONFIRMED. AWAITING PMS/OPDIV ACTION.
	THE FOLLOWING AWARD(S) REPORTED MISSING ON AN EARLIER PMS 272 WERE NOT ACCEPTED BY PMS:				
	2-G004451230		200,000	...(M10)	COPY OF AWARD DOCUMENT NOT SUBMITTED BY YOU
	3-2012456899		233,124	...(M11)	COULD NOT CONFIRM AUTHENTICITY OF AWARD

REQUEST FOR ADVANCE OR REIMBURSEMENT

(See instructions on back)

Approved by Office of Management and Budget, No. 80-R0183

PAGE OF PAGES

1. TYPE OF PAYMENT REQUESTED
a. "X" one, or both boxes: ☐ ADVANCE ☐ REIMBURSEMENT
b. "X" the applicable box: ☐ FINAL ☐ PARTIAL

2. BASIS OF REQUEST: ☐ CASH ☐ ACCRUAL

3. FEDERAL SPONSORING AGENCY AND ORGANIZATIONAL ELEMENT TO WHICH THIS REPORT IS SUBMITTED

4. FEDERAL GRANT OR OTHER IDENTIFYING NUMBER ASSIGNED BY FEDERAL AGENCY

5. PARTIAL PAYMENT REQUEST NUMBER FOR THIS REQUEST

6. EMPLOYER IDENTIFICATION NUMBER

7. RECIPIENT'S ACCOUNT NUMBER OR IDENTIFYING NUMBER

8. PERIOD COVERED BY THIS REQUEST
FROM (month, day, year)
TO (month, day, year)

9. RECIPIENT ORGANIZATION
Name :
Number and Street :
City, State and ZIP Code :

10. PAYEE (*Where check is to be sent is different than item 9*)
Name :
Number and Street :
City, State and ZIP Code :

11. COMPUTATION OF AMOUNT OF REIMBURSEMENTS/ADVANCES REQUESTED

PROGRAMS/FUNCTIONS/ACTIVITIES ►	(a)	(b)	(c)	TOTAL
a. Total program outlays to date (*As of date*)	$	$	$	$
b. *Less:* Cumulative program income				
c. Net program outlays (*Line a minus line b*)				
d. Estimated net cash outlays for advance period				
e. Total (*Sum of lines c & d*)				
f. Non-Federal share of amount on line e				
g. Federal share of amount on line e				
h. Federal payments previously requested				
i. Federal share now requested (*Line g minus line h*)				
j. Advances required by month, when requested by Federal grantor agency for use in making prescheduled advances — 1st month				
2nd month				
3rd month				

12. ALTERNATE COMPUTATION FOR ADVANCES ONLY

a. Estimated Federal cash outlays that will be made during period covered by the advance	$
b. *Less:* Estimated balance of Federal cash on hand as of beginning of advance period	
c. Amount requested (*Line a minus line b*)	$

13. CERTIFICATION

I certify that to the best of my knowledge and belief the data above are correct and that all outlays were made in accordance with the grant conditions or other agreement and that payment is due and has not been previously requested.

SIGNATURE OF AUTHORIZED CERTIFYING OFFICIAL — DATE REQUEST SUBMITTED

TYPED OR PRINTED NAME AND TITLE — TELEPHONE (AREA CODE, NUMBER, EXTENSION)

This space for agency use

270-102

STANDARD FORM 270 (7-76)
Prescribed by Office of Management and Budget
Cir. No. A-110

INSTRUCTIONS

Please type or print legibly. Items 1, 3, 5, 9, 10, 11c, 11e, 11f, 11g, 11i, 12 and 13 are self-explanatory; specific instructions for other items are as follows:

Item	*Entry*
2	Indicate whether request is prepared on cash or accrued expenditure basis. All requests for advances shall be prepared on a cash basis.
4	Enter the Federal grant number, or other identifying number assigned by the Federal sponsoring agency. If the advance or reimbursement is for more than one grant or other agreement, insert N/A; then, show the aggregate amounts. On a separate sheet, list each grant or agreement number and the Federal share of outlays made against the grant or agreement.
6	Enter the employer identification number assigned by the U.S. Internal Revenue Service, or the FICE (institution) code if requested by the Federal agency.
7	This space is reserved for an account number or other identifying number that may be assigned by the recipient.
8	Enter the month, day, and year for the beginning and ending of the period covered in this request. If the request is for an advance or for both an advance and reimbursement, show the period that the advance will cover. If the request is for reimbursement, show the period for which the reimbursement is requested.
Note:	The Federal sponsoring agencies have the option of requiring recipients to complete items 11 or 12, but not both. Item 12 should be used when only a minimum amount of information is needed to make an advance and outlay information contained in item 11 can be obtained in a timely manner from other reports.
11	The purpose of the vertical columns (a), (b), and (c), is to provide space for separate cost breakdowns when a project has been planned and budgeted by program, function, or activity. If additional columns are needed, use as many additional forms as needed and indicate page number in space provided in upper right; however, the summary totals of all programs, functions, or activities should be shown in the "total" column on the first page.
11a	Enter in "as of date", the month, day, and year of the ending of the accounting period to which this amount applies. Enter program outlays to date (net of refunds, rebates, and discounts), in the appropriate columns. For requests prepared on a cash basis, outlays are the sum of actual cash disbursements for goods and services, the amount of indirect expenses charged, the value of in-kind contributions applied, and the amount of cash advances and payments made to subcontractors and subrecipients. For requests prepared on an accrued expenditure basis, outlays are the sum of the actual cash disbursements, the amount of indirect expenses incurred, and the net increase (or decrease) in the amounts owed by the recipient for goods and other property received and for services performed by employees, contracts, subgrantees and other payees.
11b	Enter the cumulative cash income received to date, if requests are prepared on a cash basis. For requests prepared on an accrued expenditure basis, enter the cumulative income earned to date. Under either basis, enter only the amount applicable to program income that was required to be used for the project or program by the terms of the grant or other agreement.
11d	Only when making requests for advance payments, enter the total estimated amount of cash outlays that will be made during the period covered by the advance.
13	Complete the certification before submitting this request.

PMS 270

OMB NO 0990-0059
EXCEPTION TO SF 270 APPROVED BY GSA/OIRM 5/85
APPROVAL EXPIRES 12/31/87

REQUEST FOR ADVANCE OR REIMBURSEMENT	1. TYPE OF PAYMENT |XX| ADVANCE |__| REIMBURSEMENT REQUESTED	
2. FEDERAL SPONSORING AGENCY: FEDERAL ASSISTANCE FINANCING BRANCH DASP/DASF/OS/DHHS BOX 6021 ROCKVILLE, MD. 20852	3. BASIS OF REQUEST |XX| CASH |__| ACCRUAL	4. EIN 5. PAYEE ID NO. 6. ACCT. NO.
7. RECIPIENT ORGANIZATION:	8. PERIOD COVERED BY THIS REQUEST FROM_____ (MONTH, DAY, YEAR) TO_____ (MONTH, DAY, YEAR)	

9. COMPUTATION FOR ADVANCES ONLY

A. EST. FED. CASH OUTLAYS TO BE MADE DURING PERIOD_____ THRU _____ $_____

B. LESS: ESTIMATED BALANCE OF FEDERAL CASH ON HAND AS OF _____ $_____

C. AMOUNT REQUESTED (LINE A MINUS B) FOR_____ $_____

10. CERTIFICATION

I CERTIFY THAT TO THE BEST OF MY KNOWLEDGE AND BELIEF THE DATA ABOVE ARE CORRECT AND THAT ALL OUTLAYS WERE MADE IN ACCORDANCE WITH THE GRANT CONDITIONS OR OTHER AGREEMENT AND THAT PAYMENT IS DUE AND HAS NOT BEEN PREVIOUSLY REQUESTED.	SIGNATURE OF CERTIFYING OFFICIAL TYPED OR PRINTED NAME AND TITLE TELEPHONE | AREA CODE | NUMBER | EXTENSION	DATE REQUEST SUBMITTED

STANDARD FORM 270

HHS FUNDS ONLY

** DO NOT TRIM THIS EXCESS MARGIN ***

HHS FUNDS ONLY

** DO NOT TRIM THIS EXCESS MARGIN ***

HHS FUNDS ONLY

** DO NOT TRIM THIS EXCESS MARGIN ***

CHAPTER 7
Public Policy Requirements

A. PUBLIC POLICY ASSURANCES

There are a number of requirements that are based on legislation or regulation, which are termed "public policy requirements" with which applicants or grantees must comply. The following listing is not exhaustive and additional assurances or certifications may be required.

1. Civil Rights

Title VI of the Civil Rights Act of 1964 provides that no person in the United States shall, on the grounds of race, color, or national origin, be excluded from participation in, be denied the benefits of, or be subjected to discrimination under any program or activity receiving Federal financial assistance. Departmental regulations implementing this requirement are published in 45 CFR Parts 80 and 81. Every applicant organization is required to have an Assurance of Compliance (Form HEW-441 or 441-B) on file with the Office of Civil Rights, Office of the Secretary, HHS, before an HDS grant may be made to the organization.

Section 504 of the Rehabilitation Act of 1973, as amended, provides that no otherwise qualified handicapped individual in the United States shall, solely by reason of the handicap, be excluded from participation in, be denied the benefit of, or be subjected to discrimination under any program or activity receiving Federal financial assistance. A Departmental regulation implementing this requirement is published in 45 CFR Part 84. Every applicant organization is required to have an assurance of compliance (Form HEW-641) on file with the Office of Civil Rights, Office of the Secretary, HHS, before an HDS grant may be made to the organization.

2. Human Subjects

Safeguarding the rights and welfare of human subjects who are involved in activities supported by HDS program funds is the responsibility of the grantee. This applies to grantee institutions performing research, development, demonstration or other activities. For the purposes of this policy, a human subject "at risk" is an individual who may be exposed to the possibility of injury, including physical, psychological, or social injury, as a consequence of participation as a subject in any grant supported activity which departs from the application of those established and accepted methods necessary to meet the subject's needs, or which increases the ordinary risks of daily life, including the recognized risks inherent in a chosen occupation or field of service. The individuals must be protected in accordance with the provisions of HHS regulations in 45 CFR Part 46.

No HDS grant for an activity involving human subjects at risk shall be made unless:

- An assurance of compliance with Departmental policy regarding the protection of human subjects has been submitted (Form HEW 596) with the grant application (whether for new, competing continuation, or noncompeting continuation awards) by the grantee organization and is found acceptable by HHS; and

- A properly constituted committee of the grantee organization has reviewed and approved such activity and a certification is submitted with the grant application (or no later than 60 days after the deadline date for receipt of an application) stating that it has been reviewed in accordance with the organization's approved assurance. This certification must be submitted annually.

The Office for Protection from Research Risks, National Institutes of Health, Public Health Service, HHS, Bethesda, Maryland 20892, is responsible for the implementation and enforcement of this policy for the Department. Information concerning the preparation and negotiation of assurances, as well as copies of the regulation, may be obtained from that office.

3. Animal Welfare

Humane care and use of animals in HDS grant-supported projects is the responsibility of the grantee organization.

"Animal" means any live, vertebrate animal used or intended for use in research, experimentation, testing, training, or related purposes. "Animal facility" means any building, room, area, or vehicle designed to confine, transport, maintain, or use animals.

No affected HDS grant will be made unless the applicant organization has provided an acceptable written assurance to the Office of Protection from Research Risks, National Institutes of Health (NIH), Bethesda, Maryland 20014, that it will comply with applicable provisions of the Animal Welfare Act (Pub. Law 89-544, as amended) and the Department's publications *Guide for the Care and Use of Laboratory Animals* (revised 1978) and *Principles for Use of Experimental Animals*. The assurance must also indicate the means by which the organization will review its facilities for warm-blooded animals for conformance with the provisions of the *Guide*.

A complete new assurance form must be submitted once every five years. Further information may be obtained from NIH.

4. The Hatch Act

The Hatch Act (5 U.S.C. 1501-1508) specifies permitted and prohibited political activities of:.

- employees of State and local governments whose principal employment is financed in whole or in part with Federal funds; and

- any agency which assumes responsibility for planning, developing, and coordinating Head Start programs and receives assistance under the Head Start Act (Section 641(a) of Public Law 97-35). Such an agency is considered a State or local agency for purposes of this policy.

The Act does *not* cover:

- an individual who exercises no functions in connection with that activity, or

- an individual employed by an educational or research institution which is supported in whole or in part by a State or political subdivision thereof, or by a recognized religious, philanthropic, or cultural organization.

All State or local employees are free to engage in political activity to the widest extent consistent with the restrictions imposed by law and regulations (5 CFR Part 151). A State or local officer or employee may participate in all political activity not specifically restricted, including candidacy for office in a nonpartisan election and candidacy for political party office. A State or local employee may not:

- Use his or her official authority or influence for the purpose of interfering with or affecting the result of an election or nomination for office; or

- Directly or indirectly coerce, attempt to coerce, command, or advise a State or local officer or employee to pay, lend, or contribute anything of value to a political party, committee, agency, organization, or person for a political purpose; or

- Be a candidate for elective public office in a partisan election.

Section 656(b) of the Head Start Act further limits employees of Head Start organizations as follows:

"Programs assisted...shall not be carried on in a manner involving the use of program funds, the provision of services, or the employment or assignment of personnel in a manner supporting or resulting in the identification of such programs with:

- any partisan or nonpartisan political activity or any other political activity associated with a candidate, or contending faction or group, in an election for public or party office; or

- any voter registration activity; or

- any activity to provide voters or prospective voters with transportation to the polls or similar assistance in connection with any such election.

5. Fair Labor Standards Act

The Federal Fair Labor Standards Act (29 U.S.C. 201 et seq.) imposes minimum wage and maximum hour provisions, as they apply to employees of State and local governments, employees of institutions of higher education, hospitals, and other nonprofit organizations.

6. Environmental Protection and Related Legislation

The National Environment Policy Act of 1969 (Pub. L. 91-190) and related legislation establishes national policy goals and procedures for protecting and enhancing the physical environment and our cultural heritage. The provisions of this legislation are applicable to activities supported in whole or in part through grants awarded by HDS granting offices.

If HDS believes proposed projects may create an environmental impact or affect important cultural assets, special application instructions may be given. Tne Department's rules implementing this legislation are set forth in *HHS General Administration Manual Part 30.* Under the provisions of Section 106 of the National Historic Preservation Act of 1966, as amended, the Secretary of the Interior has compiled a national register of sites and buildings that are of significant importance to America's history. This listing may be obtained from the Advisory Council on Historic Preservation, 1522 K Street, N.W., Washington, D.C. 20005.

7. Flood Insurance

The Flood Disaster Protection Act of 1973 (Public Law 93-234) provides that no Federal financial assistance for construction or renovation and alteration of property may be provided in identified special flood areas in the United States unless, within one year after the affected community has been notified that it is flood-prone, the community participates in the National Flood Insurance Program, and flood insurance is purchased. Listings of flood-prone areas that are eligible for flood insurance are published in the *Federal Register* by the Department of Housing and Urban Development (HUD). Guidance on compliance with the Act is available from HUD.

8. Relocation Assistance and Real Property Acquisition

A State agency applying for HDS grant funds must assure that it will comply with the provisions required by the Uniform Relocation Assistance and Real Property Acquisition Policies Act of 1970 (Pub. L. 91-646) and the HHS regulations implementing those provisions (45 CFR Part 15). The term "State agency" means, for purposes of this subsection, State or local institutions of higher education or hospitals or private entities acting as agents or contractors in the discharge of the university or hospital's responsibilities under a grant.

The Act provides a uniform policy for the fair and equitable treatment of owners and tenants of real property who are displaced by Federal or Federally assisted programs or projects or whose real property or interests in real property is taken for or as a direct result of such programs or projects.

Title II of the Act provides for a program of relocation payments, of relocation assistance (including advisory services), of assurances that prior to the displacement of persons, comparable quality, decent, safe, and sanitary replacement housing will be available for them.

B. OTHER POLICIES

1. Citizenship

Occasionally, an individual who is a citizen of a country other than the United States may serve as a project director or otherwise participate in an HDS-supported project. HDS will not intercede on behalf of an individual whose stay in the United States may be limited by visa status. Therefore, a grantee organization shall determine, and the application should indicate, that any individual's visa will allow him or her to remain in the country a sufficient length of time to benefit the project.

2. Safety Precautions

The Office of Human Development Services assumes no responsibility with respect to accidents, illnesses or claims arising out of any work performed under a grant supported project. The grantee organization is expected to take necessary steps to insure or protect itself and its personnel and to comply with the applicable local, State and Federal safety standards.

CHAPTER 8
Recipient Procurements

A. GENERAL DISCUSSION

Cross-references: Subpart P and Appendices G and H of 45 CFR Part 74

In the past, HHS has implemented Attachment O to OMB Circular A-102 and Attachment O to OMB Circular A-110 by paraphrasing and combining the text of the two Attachments in Subpart P of Part 74. HHS has changed this method of implementation for both Attachments and now requires compliance with the Attachments which are placed in separate Appendices to 45 CFR Part 74, without paraphrasing.

Thus, the requirements governing recipient procurements of supplies, equipment, and services (including construction) are in Appendices G and H of Part 74 (as clarified in Subpart P of Part 74) and this Chapter. Governmental recipients shall comply with the standards in Appendix G and nongovernmental recipients, with the standards in Appendix H of Part 74. These requirements do not apply to procurements of land, existing land improvement or structures, or any other existing real property, but do apply to construction.

B. RELYING ON RECIPIENT'S JUDGMENT

Paragraph 2.a of Appendix G prohibits a granting office from substituting its judgment for that of a recipient government unless the matter is primarily a concern of the Federal Government (or in the case of a subgrant, a concern of either the grantee or the Federal Government). For HDS grants and subgrants, this prohibition on granting offices also applies to procurements by nongovernmental recipients that are subject to Appendix H of Part 74.

C. GRANTING OFFICE REVIEW OF PROPOSED PROCUREMENTS

Granting office pre-award review and approval of the recipient's proposed procurements and related procurement documents, such as requests for proposals and invitations for bids, is required or may be required only as follows:

Noncompetitive procurements

For both governmental and nongovernmental recipients, prior approval is required if the procurement is expected to exceed $10,000 and (1) the procurement is to be made without competition, or (2) the procurement is to be made where only one bid or offer has been received in response to a solicitation. At the discretion of the granting office, a nongovernmental recipient may be required to obtain prior approval in either of these cases if the the procurement is expected to exceed $5,000.

"Brand-Name" Procurements

Governmental recipients are required to obtain prior approval if the procurement is expected to exceed $10,000 and specifies a "brand-name" product.

Procurement System Not In Compliance

A granting office may require a governmental or nongovernmental recipient to obtain prior approval for any or all of the recipient's HDS-supported procurements and related procurement documents if the recipient's procurement procedures or operation fails to comply with one or more significant aspects of Appendices G and H of Part 74. If this occurs, the granting office shall notify the recipient in writing, with a copy of such notification to the Office of Federal Procurement Policy, OMB, Washington, D.C. 20503. If the notification is issued by a grantee to a subgrantee, the grantee shall also send a copy to the HDS granting office.

Transfers of Substantive Programmatic Work

Prior approval is required for any procurement by a governmental or nongovernmental recipient if the procurement constitutes a transfer of substantive programmatic work, as explained in Section K of Chapter 1 of this Manual. In this case, the procurement documents (request for proposals, final contract document, etc.) need not be submitted. However, unless otherwise instructed by the granting office, the recipient shall include with its request for prior approval: (1) its plans for making the procurement, including the types of parties to be solicited, and (2) the specifications or scope of work.

D. LEASE VERSUS PURCHASE

Appendices G (paragraph 8) and H (paragraph 3.C. (1)) of Part 74 require that an analysis shall be made of lease versus purchase alternatives to determine which approach would be the most economical. Generally, the decision to lease or purchase equipment should be based on the lowest cost to the project considering the length of the project and life expectancy of the equipment. In the case of educational institutions, which can pay interest in certain circumstances, consideration should also be given to the provisions regarding interest in Section J.17(e) of OMB Circular A-21. [See "Interest Costs" in Chapter 3.E of this Manual.]

E. REQUIREMENT ON EQUAL EMPLOYMENT OPPORTUNITY

Appendices G and H of Part 74 require recipients to include in contracts in excess of $10,000 a provision requiring compliance with Executive Order 11246, concerning equal employment opportunity, as supplemented in Department of Labor regulations (41 CFR Chapter 60). For HDS grants and subgrants, this requirement applies only if the contract is for construction.

If construction is to be assisted by a grant or subgrant, the Executive Order and the Department of Labor supplementing regulations apply, unless an exemption is granted by or under those regulations. Recipients shall observe all applicable requirements of the Order and regulations and include in their nonexempt construction contracts the specific clauses prescribed by 41 CFR 60–1.4(b) and, if applicable, 41 CFR 60–4.3.

CHAPTER 9
Property

A. GENERAL DISCUSSION

Cross-references: Subpart 0 and AA of 45 CFR Part 74

This Chapter and Subparts 0 and AA of Part 74 set forth applicable policies and procedures for the use and disposition of property acquired in whole or in part under grants or subgrants supported by HDS program funds. Equipment or supplies acquired by a contractor under a grant or subgrant are subject to the property requirements only if, by terms of the contract, title vests in the grantee or subgrantee. The applicability of the property requirements is discussed in 45 CFR 74.130. Special requirements pertaining to property acquired under a grant to a for-profit organization are specified in 45 CFR 74.710.

B. TITLE TO EQUIPMENT AND SUPPLIES

Subject to the obligations and conditions set forth in Subparts O of Part 74 and this Chapter, title to equipment and supplies acquired under a grant or subgrant shall vest, upon acquisition, in the grantee or subgrantee respectively.

The exception to this rule is that when equipment is acquired under a grant to a for-profit organization, title to the real property, equipment, and supplies vests in the Federal Government.

It is important to determine whether the grantee or subgrantee's budget account was used to acquire the property to know in whom title is vested. When a grantee's budget includes equipment, title vests in the grantee; conversely, when a subgrantee's budget includes equipment, title vests in the subgrantee. It, therefore, depends on whose grant or subgrant account was used to determine who has title to the equipment.

C. REAL PROPERTY

Unless authorized by the applicable program statute, neither Federal grant funds nor non-Federal cost-sharing or matching funds may be used to purchase real property. Nor may the fair market value of donated real property be counted as cost-sharing or matching. Charges for real property are subject to the depreciation or use allowance provisions of the applicable cost principles.

D. DAMAGE, LOSS, OR THEFT OF EQUIPMENT

This Section applies to equipment with a unit acquisition cost of $1,000 or more that, before disposition under 45 CFR 74.139, is damaged beyond repair, lost, or stolen.

1. Recipient at Fault

This subsection applies if:

- at the time of damage, loss, or theft, the recipient does not have a control system in effect as required by 45 CFR 74.140(c); and
- the damage, loss, or theft is not due to an act of God.

a. Equipment Replaced

If the equipment is replaced, the replacement is governed by 45 CFR 74.138(b) and (c). When that happens, the market value of the original equipment at the time it was damaged, lost, or stolen is used instead of the amount received for trade-in or sale.

b. Equipment Not Replaced

If the equipment is not replaced, the Federal Government has a right to an amount calculated by multiplying the Federal share in the equipment by its market value at the time of damage, loss, or theft. The amount is reduced pro rata if part of the Federal share of the equipment comes from an award under which the exemptions in 45 CFR 74.135 applied.

c. Other Remedies

The provisions in this subsection are in addition to other remedies available to the granting office if a recipient acquires equipment with grant or subgrant support but fails to establish the control system required by 45 CFR 74.140(c). [See in particular 45 CFR 74.7 and 74.113.]

2. Recipient Not at Fault

This subsection applies if:

- at the time of the damage, loss, or theft, the recipient does have a control system in effect as required by 45 CFR 74.140(c); or
- the damage, loss, or theft is due to or follows after an act of God.

a. Recipient Not Compensated

If the recipient is not compensated for the damage, loss, or theft through insurance or some other means, there is no obligation to HDS for the equipment.

b. Recipient Compensated

If the recipient is compensated for the damage, loss, or theft and replaces the equipment, 45 CFR 74.138 applies to the replacement equipment. If the recipient is compensated but does not replace the equipment, 45 CFR 74.139(b) applies as though the recipient had sold the equipment. [All of §74.139(b) applies including the rule permitting the amount due the Federal Government to be reduced by 10% of the proceeds or $100, whichever is greater.] The amount received for trade-in or sale is considered the lesser of (1) the amount of compensation or (2) the market value of the equipment at the time it was damaged, lost, or stolen.

E. USING OR REMITTING THE FEDERAL SHARE

This Section applies when the Federal Government has a right to an amount of money upon disposition or loss, theft, or damage of property.

Except for for-profit organizations, if the grantee's project or program for which the property was acquired is still receiving grant support from the same Federal program, the HDS granting office may authorize use of the net money due for allowable costs of that project or program. Otherwise, the net amount must be remitted to the HDS granting office by check. For-profit organizations shall follow the disposition instructions discussed in 45 CFR 74.710(e).

F. INTANGIBLE PROPERTY

1. Patents and Inventions

Cross-reference: 45 CFR 74.144

The Department's regulations on patents and inventions rising out of activities assisted by a grant are set forth in 45 CFR Parts 6 and 8. Requests for information should be addressed to:

Assistant Secretary for Health
Department of Health and Human Services
200 Independence Avenue, S.W.
Room 716 "G"
Hubert H. Humphrey Building
Washington, D.C. 20201

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2. Copyrights

This subsection supercedes 45 CFR 74.145 and applies to the copyright in any original work of authorship prepared with grant support. In addition, if ownership of a copyright or of any of the exclusive rights comprising a copyright is purchased with grant support, this Section applies to the purchased copyright or rights. Copyrights may be secured by registering a claim in the Copyright Office. Application forms and further information may be obtained from:

Register of Copyrights
Copyright Officer
Library of Congress
Washington, D.C. 20559

a. Basic rules

(1) HDS reserves a royalty-free, nonexclusive, and irrevocable license to exercise, and to authorize others to exercise, the rights for Federal Government purposes. Subject to this license the owner is free to exercise, preserve, or transfer all of its rights. The recipient shall ensure that no agreement is entered into for transferring the rights which would conflict with the nonexclusive license of HDS.

(2) One way that HDS may exercise its nonexclusive license is to authorize exercise of the rights by another project or activity that receives or has received grant support from the Federal Government. That would be considered "for Federal Government purposes".

(3) A grantee awarding a subgrant is permitted to impose subgrant terms reserving a nonexclusive license for itself, similar to the one reserved by this Section for HDS, with respect to any copyright or rights subject to this Section that arise under the subgrant.

b. Exceptions

(1) It is permissible for the other terms of an award to restrict the author (owner) from exercising, preserving, or transferring the rights. For a subgrant, the restrictions may be in the terms of the grant or subgrant or both.

(2) HDS awards training grants and other kinds of grants under which individuals are provided stipends or other financial assistance for the primary purpose of aiding them to further their education or training. Copyrightable material developed by an individual or group of individuals in the course of this education or training are exempted from the HDS right as specified in section F.2(a) (1). It is permissible for the terms of the grant to withdraw this exemption. Furthermore, the exemption does not apply if the development of the copyrightable material also receives other forms of support from the same HDS grant or any other HHS grant (such as a research grant).

CHAPTER 10

Grant Suspension, Termination, and Closeout

A. GUIDELINES AND PROCEDURES APPLICABLE TO SUSPENSION AND TERMINATION

Cross-reference: Subpart M of Part 74

1. General Consideration

Occasionally, situations arise which indicate that funding of a grant or subgrant-supported project should be discontinued because:

- The recipient has materially failed to comply with the terms and conditions of the award; or
- Continued funding is not in the best interests of the Federal Government; or
- The recipient requests termination of grant or subgrant support.

In lieu of termination, granting office officials may make a decision to *suspend* a grant or subgrant where the recipient agrees to correct noted deficiencies. A decision to *terminate* a grant or subgrant may be made by granting office officials if appropriate corrective actions are not taken during the period of suspension or if the deficiency is so serious as to warrant immediate termination. A grant or subgrant, or portion thereof, may also be terminated at a recipient's initiative. Termination of a grant may be appealed under the HHS grant appeals procedures. [see "Appeals" in Chapter 12 of this Manual.]

2. Denial of Refunding

It is important to distinguish clearly between (1) stopping support of a project by not extending the grant period with continuation awards, and (2) termination of a grant. A grant gives the recipient legal authority to obligate the funds awarded. Unless the recipient consents, HDS may cut short that right only if the recipient has materially violated the grant's terms. Therefore, HDS gives grantees an opportunity for formal appeal when an HDS granting office decides to terminate a grant without the grantee's consent. However, when refunding is denied, a grantee has the right to appeal *only* where the denial is for failure to comply with the terms of a previous award. [There are two exceptions to this general rule: both the Head Start Act and Title VIII of the Economic Opportunity Act, as amended, provide that if a Head Start or Administration for Native American grantee's application for refunding is denied (for any reason), the affected grantee must be given "reasonable notice and opportunity for a full and fair hearing".] This is because neither the approval of a project period nor the award of a grant gives the recipient any legal entitlement to receive additional awards. The HDS granting office's commitment to fund the project in succeeding budget periods of the project period is subject to the conditions listed in Chapter 1.A.4.

3. Initial Contact

When conditions are identified which may be serious enough to cause the granting office official to consider suspension or termination, the recipient shall be advised by letter of the reasons for possible suspension or termination and that failure to correct the deficiency may result in suspension or termination of the grant. The recipient shall respond in writing within thirty (30) days of the date of such letter, describing the action or the plan designed to correct the deficiency. As provided in 45 CFR 74.114 (a), suspension (or termination for cause) may be made effective at once if a delayed effective date would be unreasonable considering the HDS granting office's responsibility to protect the Federal Government's interests.

B. SUSPENSION

Cross-reference: 45 CFR 74.114

If a satisfactory written response to the letter described in A.3 above is not received within thirty (30) days, the granting office may issue a notice suspending the recipient's authority to obligate grant or subgrant funds in whole or in part. The notice of suspension will be sent by registered or certified mail and will state the reasons for the suspension, any corrective action required of the recipient, the effective date of the suspension, and identify any costs which may be incurred by the recipient during the period of suspension. Recipients should refer to 45 CFR 74.114 for a full discussion of suspension policies.

Unless HDS program regulations provide otherwise, e.g., Head Start and Native American rules, suspension shall remain in effect until (1) the recipient has taken satisfactory corrective action; (2) the recipient has given assurance that corrective action will be taken; or (3) the granting agency terminates the grant. Under (1) or (2) above, the suspension shall be lifted only by written notice from the granting office.

C. TERMINATION

1. Termination for Cause

Cross-references:

- 45 CFR 74.115 (a); and
- Chapter 12 of this Manual

If a satisfactory written response to the letter described in A.3 above is not received within thirty (30) days, the granting office may issue a notice terminating the grant or subgrant. The notice of termination will be sent by registered or certified mail and will state the reasons for the termination, together with the effective date.

2. Termination by Mutual Agreement

Cross-reference: 74 CFR 74.115 (b) (1)

The policies in the referenced Section apply to terminations mutually agreed upon by the granting office and the recipient. All such agreements shall be in writing and signed by the authorized recipient official and the responsible official of the granting office.

3. Termination Settlements

74 CFR 74.115 (c) discusses settlement of obligations incurred by the recipient prior to termination.

D. GRANT CLOSEOUT

Cross-reference: 45 CFR 74.111

Grant and subgrant closeout is the process by which the granting office determines that all applicable administrative actions and required work of the grant or subgrant have been completed by the recipient and the responsible granting office, with the possible exception of the final audit. Grants are also considered complete when the date appearing on the "'Notice of Financial Assistance Awarded" document indicating the project ending date has been reached. Grant closeout shall be completed within 180 days after the date of completion of the project. Recipients shall observe the closeout procedures prescribed in 45 CFR 74.111.

When a grantee requests a review by the Departmental Grant Appeals Board under the HHS grant appeals process, no grant closeout action will be taken during the review until a final determination is made. However, the filing of the request for the review does not affect the authority to suspend the grant during the proceedings.

E. AMOUNTS PAYABLE TO THE FEDERAL GOVERNMENT

45 CFR 74.112 discusses debt(s) that may be owed by the grantee to the Federal Government.

CHAPTER 11
Audits

A. NON-FEDERAL AUDITS

Cross-reference: Subpart H of 45 CFR Part 74

Subpart H of 45 CFR Part 74 (and 45 CFR Part 74, Appendix J) incorporates the audit requirements in OMB Circular A-128 covering governmental recipients and OMB Circular A-110 (Attachment F) for nongovernmental recipients. The audit requirements in Circulars A-128 and A-110 are reproduced in Attachment A of this Manual. In summary, Circular A-128 replaces Attachment P to OMB Circular A-102. The Circular implements the Single Audit Act of 1984. All governmental recipients receiving $100,000 or more in Federal funds are to be audited annually unless the government has specific authority to perform less frequent audits. Circular A-110 provides that each recipient must have itself audited by non-Federal auditors at least every two years and that the audit is to be performed on an organization-wide basis, with appropriate sampling of grant-related transactions. Unless authorized by program legislation or regulations, the granting office may not impose grant-by-grant (or subgrant-by-subgrant) audit requirements.

The audit provisions do not limit the authority of Federal agencies to make audits of recipient organizations. However, if independent audits arranged for by recipients meet the requirements prescribed in the OMB Circulars, all Federal agencies must rely on them, and any additional work must build upon the work already done.

Recipients are required to have audits performed by individuals who are sufficiently independent of those who authorize the expenditure of project funds in order to produce unbiased opinions, conclusions, and judgments. These audits may be conducted by (1) an internal auditor of the recipient organization who meets the standard of independence; or (2) an independent accountant selected by the recipient, who is certified or licensed by a regulatory authority of a State or other political subdivision of the United States. When public accountants are to perform the audits, only certified public accountants or those public accountants licensed on or before December 31, 1970, or persons working for a certified public accounting firm or a public accounting firm licensed on or before December 31, 1970, should be engaged. The following General Accounting Office publications provide additional information on audits and may be obtained as follows:

- "Standards for Audit of Governmental Organizations, Programs, Activities, and Functions" (1981 Revision) available from the:.

  Superintendent of Documents
  U.S. Government Printing Office
  Washington, D.C. 20402

- "Guidelines for Financial and Compliance Audit of Federally Assisted Programs" (February 1980) available from the:

  U.S. General Accounting Office
  Distribution Section, Room 1518
  441 "G" Street, N.W.
  Washington, D.C. 20548

Failure to submit timely responses will result in a unilateral determination on the audit findings. If appropriate, the Action Official will also initiate "safeguard" procedures to protect the Government's interests. At the completion of the audit resolution process, the grantee will be notified of the final decision. The grantee may appeal this decision in accordance with the applicable appeal procedures. [See Chapter 12.]

B. AUDIT RESOLUTION

Grantees must take timely and appropriate action to resolve audit findings and recommendations, including (1) management and systems deficiencies and (2) monetary findings (i.e., questioned costs). Grantees are usually allowed a 30-day period from the date of request to respond to the responsible audit resolution official (referred to as the "Action Official") concerning audit findings. Thus, grantee organizations have an opportunity to provide any further information they may wish to provide on the audit report. Both monetary and nonmonetary findings must be resolved within six months. This means that (1) a final decision on the amount of any monetary recovery must be reached and (2) a satisfactory plan of corrective action, including time schedules, to correct all deficiencies must be established.

C. DEBT COLLECTION

Funds owed to the Federal Government as a result of audit disallowances signed by the appropriate HDS official must be repaid. The Finance Office is primarily responsible for interest calculation and all other debt collection activities. Interest charges will be assessed from the date of the HDS Official's notification of the disallowance if the disallowance is not paid within 30 days of the date of the disallowance letter. If the grantee appeals the final decision and the disallowed amount is sustained in its entirety or is reduced through a negotiated agreement, interest will be charged for the full period on the sustained amount of the disallowance which was not paid by the date of the disallowance letter.

CHAPTER 12
Appeals

A. GENERAL DISCUSSION

Cross-references: 45 CFR 16 and 75

Grantees have the right to appeal certain adverse final decisions by HHS officials. The following decisions may be appealed in all HDS discretionary grant programs:

- Termination, in whole or in part, of a grant for failure of the grantee to conform with the grant terms and conditions, including any law, regulation, or assurance applicable to the grant;
- A denial of a noncompeting continuation award under the project period system of funding where the denial is for failure to comply with terms of a previous award;
- A disallowance or other determination denying payment of an amount claimed under an award, or requiring return or offset of funds already received. This does not apply to determinations of award amount, disposition of unobligated balances, or selection in the award document of an option for disposition of program income;
- Annulment (voiding) of a grant (i.e., a decision that an award is invalid because it was not authorized by statute or regulation or because it was fraudulently obtained);
- Cost allocation plans negotiated with State and local governments; and
- Indirect cost rates, research patient care rates and amounts, computer, fringe benefit, and other special rates.

In reviewing cost allocation and rate disputes, the Board reviews the final written decisions issued as a result of the preliminary appeal process at 45 CFR Part 75.

B. INDIRECT COST RATE APPEALS

Cross-reference: 45 CFR Part 75

Informal procedures for resolving disputes arising from determinations made by a Director in the HHS Regional Division of Cost Allocation (DCA) are set forth in 45 CFR Part 75, "Informal Grant Appeals Procedures". When an agreement cannot be reached in a negotiation, the Director, DCA, will promptly notify the grantee in writing of the Director's determination. Grantees must submit their written request for reconsideration to the appropriate HHS Regional Director (RD) no later than thirty (30) days after the postmark date of the notification to the grantee, unless an extension of time is granted by the RD. Although the reconsideration application need not follow any prescribed format, it must clearly identify the issue(s) in dispute and must contain a full statement of the grantee's position on the issue(s) along with pertinent facts and reasons in support of its position.

If the Regional Director's decision is adverse to the grantee, the notification will state the basis of the decision and will inform the grantee of its right to appeal the decision to the Departmental Grant Appeals Board under 45 CFR Part 16. Such an appeal must be made within thirty (30) days after the postmark date of the written notification or the decision will become final (unless an extension is granted by the Grant Appeals Board).

C. APPEALS TO GRANT APPEALS BOARD

Cross-references: 45 CFR Parts 16 and 74.304

Grantees may appeal certain adverse decisions to the Departmental Grant Appeals Board under 45 CFR Part 16. The Departmental Grant Appeals Board is in the Office of the Secretary of HHS. Filing shall be made with the Executive Secretary, Grant Appeals Board, U.S. Department of Health and Human Services, 330 C Street S.W., Switzer Building, Washington, D.C. 20201.

The appellant must have received a final decision, and must appeal that decision within 30 days after receiving it. Details of how final decisions are developed and issued, and what must be in them, are contained in 45 CFR 74.304.

The notice of appeal must be submitted by registered or certified mail directly to the Board and need not follow any prescribed form. The notice of appeal must include a copy of the final decisions, a statement of the amount in dispute in the appeal, and a brief statement of why the decision is wrong.

The responsible HDS granting office is notified by the Grant Appeals Board when such an appeal has been made. The filing of the application for appeal shall not affect HDS authority to suspend the grant during appeal proceedings or to withhold payments under the grant.

ATTACHMENT A

45 CFR Part 74
and
Relevant OMB Circulars

DEPARTMENT OF
HEALTH AND HUMAN SERVICES

ADMINISTRATION OF GRANTS

FEDERAL REGULATIONS
Title 45 Part 74

PLUS
OMB REQUIREMENTS FOR NON-FEDERAL AUDITS

OFFICE OF THE SECRETARY, OFFICE OF GRANTS AND PROCUREMENT

Code of Federal Regulations

Title 45—Public Welfare

Subtitle A—DEPARTMENT OF HEALTH AND HUMAN SERVICES
GENERAL ADMINISTRATION

PART 74—ADMINISTRATION OF GRANTS

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*Appendix E is not included in this reprint of Part 74. A copy of Appendix E may be obtained from the Division of Cost Allocation in any Regional Office of the Department.

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SUBPART A
General

§ 74.1 Purpose and scope of this part.

This part establishes uniform requirements for the administration of HHS grants and principles for determining costs applicable to activities assisted by HHS grants.

§ 74.2 Scope of subpart.

This subpart contains general rules pertaining to this Part 74 (definitions, purpose and scope, applicability, and appeals) and procedures for control of deviations from the part.

§ 74.3 Definitions.

As used in this part:

"Awarding party" means (1) with respect to a grant, the granting agency, and (2) with respect to a subgrant, the grantee. (See § 74.4(b))

"Contract" means (except as used in the definitions for "grant" and "subgrant" in this section and except where qualified by "Federal") a procurement contract under a grant or subgrant, and "subcontract" means a procurement subcontract under such a contract.

"Cost-type contract" means a contract or subcontract in which the contractor or subcontractor is paid on the basis of the costs it incurs, but the term does not include such subcontracts under a non-cost-type contract or subcontract.

"Expenditure report" means: (1) For nonconstruction grants, the "Financial Status Report" (or other equivalent report); (2) for construction grants, the "Outlay Report and Request for Reimbursement for Construction Programs" (or other equivalent report). (See subpart I of this part.)

"Federally recognized Indian tribal government" means the governing body or a governmental agency of any Indian tribe, band, nation, or other organized group or community (including any Native village as defined in section 3 of the Alaska Native Claims Settlement Act, 85 Stat. 688) certified by the Secretary of the Interior as eligible for the special programs and services provided by him through the Bureau of Indian Affairs. However, for policies applicable to tribal government hospitals and institutions of higher education, see § 74.4(c), "Applicability of this part."

"Government" means a State or local government or a Federally recognized Indian tribal government. However, for policies applicable to government hospitals and institutions of higher education, see § 74.4(c), "Applicability of this part."

"Grant" means an award of financial assistance in the form of money, or property in lieu of money, by the Federal Government to an eligible recipient. The term includes such financial assistance when provided by contract, but does not include any Federal procurements subject to the procurement regulations in 41 CFR, nor does it include technical assistance, which provides services instead of money, or other assistance in the form of revenue sharing, loans, loan guarantees, interest subsidies, insurance, or direct appropriations. Also, the term does not include assistance, such as a fellowship or other lump sum award, which the recipient is not required to account for on an actual cost basis.

"Grantee" means the government, nonprofit corporation, or other legal entity to which a grant is awarded and which is accountable to the Federal Government for the use of the funds provided. The grantee is the entire legal entity even if only a particular component of the entity is designated in the award document. For example, a grant award document may name as the grantee an agency of a State, or one school or campus of a university. In these cases, the granting agency usually intends, or actually requires, that the named component assume primary or sole responsibility for administering the grant-assisted project or program. Nevertheless, the naming of a component of a legal entity as the grantee in a grant award document shall not be construed as relieving the whole legal entity from accountability to the Federal Government for the use of the funds provided. (This definition is not intended to affect the eligibility provisions of grant programs in which eligibility is limited to organizations, such as State welfare departments, which may be only components of a legal entity.) The term "grantee" does not include any secondary recipients such as subgrantees, contractors, etc., who may receive funds from a grantee pursuant to a grant.

"Granting agency" means any organizational component of HHS authorized to award and administer grants.

"HHS" means the U.S. Department of Health and Human Services.

"Local government" means a local unit of government including specifically a county, municipality, city, town, township, local public authority, school district, special district, intrastate district, council of governments (whether or not incorporated as a nonprofit corporation under State law), "sponsor or sponsoring local organization" of a watershed project (as defined in 7 CFR 620.2, 40 FR 12472, March 19, 1975), any other regional or interstate government entity, or any agency or instrumentality of a local government. However, for policies applicable to government hospitals and institutions of higher education, see § 74.4(c), "Applicability of this part."

"OGP" means the Office of Grants and Procurement, which is an organizational component within the Office of the Secretary, HHS, and reports to the Assistant Secretary for Management and Budget.

"OMB" means the Office of Management and Budget within the Executive Office of the President.

"Recipient" means grantee or subgrantee. (See § 74.4(b).)

"State" means any of the several States of the United States, the District of Columbia, the Commonwealth of Puerto Rico, any territory or possession of the United States, or any agency or instrumentality of a State exclusive of local governments. However, for policies applicable to government hospitals and institutions of higher education, see § 74.4(c), "Applicability of this part."

"Subgrant" means an award of financial assistance in the form of money, or property in lieu of money, made under a grant by a grantee to an eligible subgrantee. The term includes financial assistance when provided by contract, but does not include procurements; nor does it include any form of assistance which is excluded from the definition of "grant" in this section.

"Subgrantee" means the government, nonprofit corporation, or other legal entity to which a subgrant is awarded and which is accountable to the grantee for the use of the funds provided. The subgrantee is the entire legal entity even if only a particular component of the entity is designated in the subgrant award document.

"Terms of a grant or subgrant" means all requirements of the grant or subgrant, whether in statute, regulations, the award document or elsewhere.

§ 74.4 Applicability of this part.

(a) *General.* Except where inconsistent with Federal statutes, regulations, or other terms of a grant, this part applies to all HHS grants. However, unless expressly made applicable by the granting agency, this part shall not apply when the grantee is a Federal agency, foreign government or organization, international organization such as the United Nations, for-profit organization, or individual.

(b) *Subgrants.* For each substantive provision in this part, either the language of the provision itself or other text in the same subpart will indicate whether the provision affects only grants, only subgrants, or both. Use of the term "recipient" (as defined in § 74.3) in a provision shall be taken as referring equally to grantees and subgrantees. Similarly, use of the term "awarding party" (as defined in § 74.3) shall be taken as referring equally to granting agencies and to grantees awarding subgrants. However, unless expressly made applicable by the granting agency, this part need not be applied by the grantee to a subgrant if the subgrantee is a Federal agency, foreign government or organization, international organization such as the United Nations, for-profit organization, or individual.

(c) *Public institutions of higher education and hospitals.* Grants and subgrants to institutions of higher education and hospitals operated by a government shall be subject only to provisions of this subpart that apply to nongovernmental organizations.

§ 74.5 Appeals.

In accordance with parts 16 and 75 of this title, grantees may appeal certain postaward administrative decisions made by HHS officials.

§ 74.6 Deviations.

(a) Except as provided in § 74.7, a deviation is any exception to this part not required by Federal statute without allowance of agency discretion. A deviation may be either:

(1) Use of any policy, procedure, form, standard, or grant or subgrant term which is inconsistent with an applicable provision of this part, or

(2) Failure to use any applicable policy, procedure, form, standard, or grant or subgrant term which is required by this part.

(b) In order to maintain uniformity to the greatest extent feasible, deviations shall be kept to a minimum. A deviation, whether proposed by an applicant, a recipient, or an official of the granting agency, may be authorized only when it is necessary to meet programmatic objectives, or to conserve grant funds, or when it is otherwise essential in the public interest.

(c) Except as provided in paragraph (d) of this section, a deviation from this part may be made only when authorized by both:

(1) The head of the granting agency or other officials if designated in or pursuant to formal deviation control procedures established by the agency, and

(2) OGP.

(d) Deviations from subpart Q of this part and appendixes C, D, E, and F to this part in individual cases (i.e., where only a single grant or subgrant is involved) shall not require OGP approval.

§ 74.7 Special grant or subgrant conditions.

(a) Without regard to the deviation control procedures of § 74.6, special grant conditions more restrictive than those prescribed in this part 74 may be imposed as needed when the granting agency has determined that the grantee:

(1) Is financially unstable,

(2) Has a history of poor performance, or

(3) Has a management system which does not meet the standards of this part.

(b) When special conditions are imposed under

paragraph (a) of this section, the grantee will be notified in writing:

(1) Why the special conditions were imposed and

(2) What corrective action is needed.

Furthermore, in accordance with OMB Circulars A-102 and A-110, OMB and other Federal agencies in a granting relationship with the grantee will be provided copies of the notice to the grantee.

(c) Grantees may apply the provisions of paragraphs (a) and (b) of this section to their subgrantees. Whenever they do so, a copy of the notice to the subgrantee shall be furnished to the granting agency.

SUBPART B
Cash Depositories

§ 74.10 Physical segregation and eligibility.

Except as provided in § 74.11, awarding parties shall not impose grant or subgrant terms which:

(a) Require the recipient to use a separate bank account for the deposit of grant or subgrant funds, or

(b) Establish any eligibility requirements for banks or other financial institutions in which recipients deposit grant or subgrant funds.

§ 74.11 Checks-paid basis letter of credit.

A separate bank account shall be used when payments under letter of credit are made on a "checks-paid" basis. A checks-paid basis letter of credit is one under which funds are not drawn until the recipient's checks have been presented to its bank for payment. (See Subpart K for definition of "letter of credit.")

§ 74.12 Minority-owned banks.

Consistent with the national goal of expanding opportunities for minority business enterprises, grantees and subgrantees are encouraged to use minority-owned banks. Upon request, OGP will furnish a list of minority-owned banks.

SUBPART C
Bonding and Insurance

§ 74.15 General.

In administering grants and subgrants, recipients shall observe their regular requirements and practices with respect to bonding and insurance. No additional bonding and insurance requirements, including fidelity bonds, shall be imposed by the terms of the grant or subgrant except as provided in §§ 74.16 through 74.18.

§ 74.16 Construction and facility improvement.

(a) *Scope of this section.* This section covers requirements for bid guarantees, performance bonds, and payments bonds when the recipient will contract for construction or facility improvement (including alterations and renovations of real property) under a grant or subgrant.

(b) *Definitions.* (1) "Bid guarantee" means a firm commitment such as a bid bond, certified check, or other negotiable instrument accompanying a bid as assurance that the bidder will, if its bid is accepted, execute the required contractual documents within the time specified.

(2) "Performance bond" means a bond executed in connection with a contract to secure fulfillment of all the contractor's obligations under the contract.

(3) "Payment bond" means a bond executed in connection with a contract to assure payment as required by law of all persons supplying labor and material in the execution of the work provided for in the contract.

(c) *Bids and contacts of $100,000 or less.* The recipient shall follow its own requirements and practices relating to bid guarantees, performance bonds, and payment bonds.

(d) *Bids and contracts exceeding $100,000.* The recipient may follow its own regular policy and requirements if the HHS granting agency has determined that the Federal Government's interest will be adequately protected. If this determination has not been made, the minimum requirements shall be as follows:

(1) A bid guarantee from each bidder equivalent to 5 percent of the bid price;

(2) A performance bond on the part of the contractor for 100 percent of the contract price; and

(3) A payment bond on the part of the contractor for 100 percent of the contract price.

§ 74.17 Fidelity bonds.

(a) If the grantee is not a government, the granting agency may require it to carry adequate fidelity bond coverage where the absence of coverage for the grant-supported activity is considered as creating an unacceptable risk.

(b) If the subgrantee is not a government, the granting agency or the grantee may require that it carry adequate fidelity bond coverage where the absence of coverage for the subgrant-supported activity is considered as creating an unacceptable risk.

(c) A fidelity bond is a bond indemnifying the recipient against losses resulting from the fraud or lack of integrity, honesty or fidelity of one or more employees, officers or other persons holding a position of trust.

§ 74.18 Source of bonds.

Any bonds required under §§ 74.16(d)(1) through (3) or 74.17 shall be obtained from companies holding certificates of authority as acceptable sureties (31 CFR Part 223). A list of these companies is published annually by the Department of the Treasury in its Circular 570.

SUBPART D
Retention and Access Requirements for Records

§ 74.20 Applicability.

(a) This subpart applies to all financial and programmatic records, supporting documents, statistical records and other records of recipients, which are:

(1) Required to be maintained by the terms of an HHS grant, or

(2) Otherwise reasonably considered as pertinent to an HHS grant.

(b) This subpart does not apply to the records of contractors and subcontractors under grants and subgrants. For a requirement to place a provision concerning those records in certain kinds of contracts, see Subpart P and Appendices G and H of this part.

§ 74.21 Length of retention period.

(a) Except as provided in paragraphs (b) and (c) of this section, records shall be retained for 3-years from the starting date specified in § 74.22.

(b) If any litigation, claim, negotiation, audit or other action involving the records has been started before the expiration of the 3-year period, the records shall be retained until completion of the action and resolution of all issues which arise from it, or until the end of the regular 3-year period, whichever is later.

(c) In order to avoid duplicate recordkeeping, awarding parties may make special arrangements with recipients to retain any records which are continuously needed for joint use. The awarding party will request transfer of records to its custody when it determines that the records possess long-term retention value. When the records are transferred to or maintained by the awarding party the 3-year retention requirement is not applicable to the recipient.

§ 74.22 Starting date of retention period.

(a) *General.* (1) Where HHS grant support is continued or renewed at annual or other intervals, the retention period for the records of each funding period starts on the day the grantee submits to HHS its single or last expenditure report for that period. However, if HHS grant support is continued or renewed quarterly, the retention period for each year's records starts on the day the grantee submits to HHS its expenditure report for the last quarter of the Federal fiscal year. In all other cases, the retention period starts on the day the grantee submits its final expenditure report to HHS. If an expenditure report has been waived, the retention period starts on the day the report would have been due. "Expenditure report" is defined in § 74.3.

(2) Exceptions to this paragraph are contained in paragraphs (b) through (d) of this section.

(b) *Equipment records.* The retention period for the equipment records required by § 74.140(a) starts from the date of the equipment's disposition (§ 74.139) or replacement (§ 74.138) or transfer at the direction of the awarding party (§ 74.136).

(c) *Records for income transactions after grant or subgrant support.* (1) In some cases an HHS requirement concerning the disposition of program income, as defined in subpart F of this part, will be satisfied by applying the income to costs incurred after expiration or termination of grant or subgrant support for the activity giving rise to the income. In such a case, the retention period for the records pertaining to the costs starts from the end of the recipient's fiscal year in which the costs are incurred.

(2) In some cases, there may be an HHS requirement concerning the disposition of copyright royalties or other program income which is earned after expiration or termination of grant or subgrant support. Where there is such a requirement, the retention period for the records pertaining to the earning of the income starts from the end of the recipient's fiscal year in which the income is earned. (See subpart F of this part.)

(d) *Indirect cost rate proposals, cost allocation plans, etc.*—(1) Applicability. This paragraph applies to the following types of documents, and their supporting records:

(i) Indirect cost rate computations or proposals;

(ii) Cost allocation plans under Appendix C to this part;

(iii) Hospital patient care rate computations or proposals; and

(iv) Any similar accounting computations of the rate at which a particular group of costs is chargeable (such as computer usage chargeback rates or composite fringe benefit rates).

(2) *If submitted for negotiation.* If the proposal, plan, or other computation is required to be submitted to the Federal Government (or to the grantee) to form the basis for negotiation of the rate, then the 3-year retention period for its supporting records starts from the date of such submission.

(3) *If not submitted for negotiation.* If the proposal, plan, or other computation is not required to be submitted to the Federal Government (or to the grantee) for negotiation purposes, then the 3-year retention period for the proposal, plan, or computation and its supporting records starts from the end of the fiscal year (or other accounting period) covered by the proposal, plan, or other computation.

§ 74.23 Substitution of microfilm.

Copies made by microfilming, photocopying, or similar methods may be substituted for the original records.

§ 74.24 Access to records.

(a) *Records of grantees.* HHS and the Comptroller General of the United States, or any of their authorized representatives, shall have the right of access to any books, documents, papers, or other records of the grantee which are pertinent to the HHS grant, in order to make audit, examination, excerpts, and transcripts.

(b) *Records of subgrantees.* HHS, the Comptroller General of the United States, and the grantee, or any of their authorized representatives, shall have the right of access to any books, documents, papers, or other records of the subgrantee which are pertinent to the HHS grant, in order to make audit, examination, excerpts, and transcripts.

(c) [Reserved].

(d) *Expiration of right of access.* The rights of access in this section shall not be limited to the required retention period but shall last as long as the records are retained.

§ 74.25 Restrictions on public access.

Unless required by Federal statutes, awarding parties may not impose grant or subgrant terms which limit public access to records covered by this subpart except after a determination by the granting agency that the records must be kept confidential and would have been excepted from disclosure under HHS's "Freedom of Information" regulation (part 5 of this title) if the records had belonged to HHS. This section does not require recipients to permit public access to their records.

SUBPART E
Waiver of Single State Agency Requirements

§ 74.30 Policy.

Requests to HHS from Governors, or other duly constituted State authorities, for waiver of single State agency requirements in accordance with section 204 of the Intergovernmental Cooperation Act of 1968 will be given expeditious handling. Whenever possible, such requests will be granted.

SUBPART F
Grant Related Income

§ 74.40 Scope of subpart.

This subpart contains policies and requirements relating to (a) program income and (b) interest and other investment income earned on advances of grant funds.

§ 74.41 Meaning of program income.

(a) Except as explained in paragraphs (b) and (c) of this section, program income means gross income earned by a recipient from activities part or all of the cost of which is either borne as a direct cost by a grant or counted as a direct cost towards meeting a cost sharing or matching requirement of a grant. It includes but is not limited to such income in the form of fees for services performed during the grant or subgrant period, proceeds from sale of tangible personal or real property, usage or rental fees, and patent or copyright royalties. If income meets this definition, it shall be considered program income regardless of the method used to calculate the amount paid to the recipient—whether, for example, by a cost-reimbursement method or fixed price arrangement. Nor will the fact that the income is earned by the recipient from a Federal procurement contract or from a procurement contract under a Federal grant awarded to another party affect the income's classification as program income.

(b) For research grants that are subject to an institutional cost-sharing agreement, income shall be considered program income only if it is earned from an activity part or all of the cost of which is borne as a direct cost by the Federal grant funds. An institutional cost-sharing agreement is one entered into between HHS and a grantee covering all of HHS's research project grants to the grantee in the aggregate.

(c) The following shall not be considered program income:

(1) Revenues raised by a government recipient under its governing powers, such as taxes, special assessments, levies, and fines. (However, the receipt and expenditure of such revenues shall be recorded as a part of grant or subgrant project transactions when such revenues are specifically earmarked for the project in accordance with the terms of the grant or subgrant.)

(2) Tuition and related fees received by an institution of higher education for a regularly offered course taught by an employee performing under a grant or subgrant.

(d) For the purposes of this subpart, program income is divided into several categories. Each category is treated in a separate section of this subpart.

§ 74.42 General program income.

(a) *Definition.* General program income means all program income accruing to a grantee during the period of grant support or to a subgrantee during the period of subgrant support, other than the special categories of such income treated in §§ 74.43 through 74.45.

(b) *Use.* (1) General program income shall be retained by the recipient and used in accordance with one or a combination of the alternatives in paragraphs (c), (d), and (e) of this section, as follows: The alternative in paragraph (c) may always be used by recipients and must be used if neither of the other two alternatives is permitted by the terms of the grant. The alternatives in paragraphs (d) or (e) may be used only if expressly permitted by the terms of the grant. In specifying alternatives that may be used, the terms of the grant may distinguish between income earned by the grantee and income earned by subgrantees and between the sources, kinds, or amounts of income.

(2) The terms of a subgrant may restrict the use of general program income earned by the subgrantee to only one or some of the alternatives permitted by the terms of the grant, but the alternative in paragraph (c) of this section shall always be permitted.

(c) *Deduction alternative.* (1) Under this alternative, the income is used for allowable costs of the project or program. If there is a cost-sharing or matching requirement, costs borne by the income may not count toward satisfying that requirement. Therefore, the maximum percentage of Federal participation is applied to the net amount determined by deducting the income from total allowable costs and third-party in-kind contributions. The income shall be used for current costs unless the granting agency authorizes deferral to a later period.

(2) To illustrate this alternative, assume a project in which the grantee incurs $100,000 of allowable costs and receives no third-party in-kind contributions. If the grantee earns $10,000 in general program income and this alternative applies, that $10,000 must be deducted from the $100,000 before applying the maximum percentage of Federal participation. If that percentage is 90 percent, the most that could be paid to the grantee would therefore be $81,000 (90 percent times $90,000).

(d) *Cost-sharing or matching alternative* (1) Under this alternative, the income is used for allowable costs of the project or program but, in this case, the costs borne by the income may count toward satisfying a cost-sharing or matching requirement. Therefore, the maximum percentage of Federal participation is applied to total allowable costs and third-party in-kind

contributions. The income shall be used for current costs unless the granting agency authorizes deferral to a later period.

(2) To illustrate this alternative, assume the same situation as in paragraph (c)(2) of this section. Under this alternative, the 90 percent maximum percentage of participation would be applied to the full $100,000, and $90,000 could therefore be paid to the grantee. (It should be noted that if $20,000 of general program income is earned, only $80,000 could be paid, since a grant cannot pay for costs which have been borne by general program income.)

(e) *Additional costs alternative.* Under this alternative, the income is used for costs which are in addition to the allowable costs of the project or program but which nevertheless further the objectives of the Federal statute under which the grant was made. Provided that the costs borne by the income further the broad objectives of that statute, they need not be of a kind that would be permissible as charges to Federal funds.

Examples of purposes for which the income may be used are:

(1) Expanding the project or program.

(2) Continuing the project or program after grant or subgrant support ends.

(3) Supporting other projects or programs that further the broad objectives of the statute.

(4) Obtaining equipment or other assets needed for the project or program or for other activities that further the statute's objectives.

§ 74.43 Program income—proceeds from sale of real property and from sale of equipment and supplies acquired for use.

The following kinds of program income shall be governed by subpart O of this part:

(a) Proceeds from the sale of real property purchased or constructed under a grant or subgrant.

(b) Proceeds from the sale of equipment and supplies fabricated or purchased under a grant or subgrant and intended primarily for use in the grant- or subgrant-supported project or program rather than for sale or rental.

§ 74.44 Program income—royalties and other income earned from a copyrighted work.

(a) This section applies to royalties, license fees, and other income earned by a recipient from a copyrighted work developed under the grant or subgrant. Income of that kind is covered by this section whether a third party or the recipient itself acts as the publisher, seller, exhibitor, or performer of the copyrighted work. In some cases the recipient incurs costs to earn the income but does not charge these costs to HHS grant funds, to required cost-sharing or matching funds, or to other program income. Costs of that kind may be deducted from the gross income in order to determine how much must be treated as program income.

(b) The terms of the grant govern the disposition of income subject to this section. If the terms do not treat this kind of income, there are no HHS requirements governing the disposition. A grantee is not prohibited from imposing requirements of its own on the disposition of this kind of income which is earned by its subgrantees provided those requirements are in addition to and not inconsistent with any requirements imposed by the terms of the grant.

§ 74.45 Program income—royalties or equivalent income earned from patents or from inventions.

Disposition of royalties or equivalent income earned on patents or inventions arising out of activities assisted by a grant or subgrant shall be governed by determinations made or agreements entered into under HHS's patent regulations. (See parts 6 and 8 of this title.) If the determination or agreement does not provide for the disposition of the royalties or equivalent income, the disposition shall be in accordance with the recipient's own policies.

§ 74.46 Program income after grant or subgrant support not otherwise treated.

(a) This section applies to program income not treated elsewhere in this part which arises from or is attributable to an activity while supported by a grant or subgrant but which does not accrue until after the period of grant or subgrant support. An example is proceeds from the sale or rental of a residual inventory of merchandise fabricated or purchased by a grant-supported workshop during the period of support.

(b) The terms of the grant govern the disposition of income subject to this section. If the terms do not treat this kind of income, there are no HHS requirements governing the disposition. A grantee is not prohibited from imposing requirements of its own on the disposition of this kind of income which is earned by its subgrantees provided those requirements are in addition to and not inconsistent with any requirements imposed by the terms of the grant.

§ 74.47 Interest earned on advances of grant funds.

(a) Except when exempted by Federal statute (see paragraph (b) of this section for the principal exemption), grantees shall remit to the Federal Government any interest or other investment income earned on advances of HHS grant funds. This includes any interest or investment income earned by subgrantees and cost-type contractors on advances to them that are attributable to advances of HHS grant funds to the grantee. Unless the grantee receives other instructions

from the responsible HHS official, the grantee shall remit the amount due by check or money order payable to the Department of Health and Human Services.

(b) In accordance with the Intergovernmental Cooperation Act of 1968 (Pub. L. 90-577), States, as defined in the act, shall not be accountable to the Federal Government for interest or investment income earned by the State itself, or by its subgrantees, where this income is attributable to grants-in-aid, as defined in the act (42 U.S.C. 4213).[1]

(c) Recipients are cautioned that they are subject to the provisions in § 74.61(e) for minimizing the time between the transfer of advances and their disbursement. Those provisions apply even if there is no accountability to the Federal Government for interest or other investment income earned on the advances.

[1] "State" is defined in the act to include any agency or instrumentality of a State, and the definition does not exclude a hospital or institution of higher education which is such an agency or instrumentality. "Grant-in-aid" is defined in the act to exclude "payments under research and development contracts or grants which are awarded directly and on similar terms to all qualifying organizations, whether public or private." (42 U.S.C. 4201)

SUBPART G
Cost Sharing or Matching

§ 74.50 Scope of subpart.

(a) This subpart contains rules for satisfying Federal requirements for cost-sharing or matching. These rules apply whether the cost sharing or matching is required by Federal statute or by other terms of the grant.

(b) HHS and a grantee may enter into an institutional cost-sharing agreement covering all of HHS's research project grants to that grantee in the aggregate. Except as provided by the institutional cost-sharing agreement, this subpart applies to the satisfaction of the grantee's obligation under the agreement, as well as to the satisfaction of cost-sharing or matching requirements that apply only to a single grant.

§ 74.51 Definitions.

For purposes of this subpart:

"Cost sharing or matching" means the value of third-party in-kind contributions and that portion of the costs of a grant-supported project or program not borne by the Federal Government.

"Equipment" has the same meaning given to that term in § 74.132, except that instead of "acquisition cost," the words "market value at the time of donation" shall be substituted.

"Supplies" means all tangible personal property other than "equipment" as defined in this section.

"Third-party in-kind contributions" means property or services which benefit a grant-supported project or program and which are contributed by non-Federal third parties without charge to the grantee, the subgrantee, or a cost-type contractor under the grant or subgrant.

§ 74.52 Basic rule: Costs and contributions acceptable.

With the qualifications and exceptions listed in § 74.53, a cost-sharing or matching requirement may be satisfied by either or both of the following:

(a) Allowable costs incurred by the grantee, subgrantee, or a cost-type contractor under the grant or subgrant. This includes allowable costs borne by non-Federal grants or by other cash donations from non-Federal third parties.

(b) The value of third-party in-kind contributions applicable to the period to which the cost-sharing or matching requirement applies.

§ 74.53 Qualifications and exceptions.

(a) *Costs borne by other Federal grants.* (1) Except as provided by Federal statute, a cost-sharing or matching requirement may not be met by costs borne by another Federal grant. This prohibition does not apply to costs borne by general program income earned from a contract awarded under another Federal grant.

(2) For the purposes of this part, general revenue sharing funds under 31 U.S.C. 1221 are not considered a Federal grant. Therefore, in the absence of any provision of Federal statute to the contrary, allowable costs borne by these funds may count towards satisfying a cost-sharing or matching requirement.

(b) *Costs or contributions counted towards other Federal cost-sharing requirements.* Neither costs nor the values of third-party in-kind contributions may count towards satisfying a cost-sharing or matching requirement of an HHS grant if they have been or will be counted towards satisfying a cost-sharing or matching requirement of another Federal grant, a Federal procurement contract, or any other award of Federal funds.

(c) *Costs financed by general program income.* Costs financed by general program income, as defined in § 74.42, shall not count towards satisfying a cost-sharing or matching requirement of the HHS grant supporting the activity giving rise to the income unless the terms of the grant expressly permit the income to be

used for cost sharing or matching. (This is the alternative for use of general program income described in § 74.42(d).)

(d) *Records.* Costs and third-party in-kind contributions counting towards satisfying a cost-sharing or matching requirement must be verifiable from the records of recipients or cost-type contractors. These records must show how the value placed on third-party in-kind contributions was arrived at. To the extent feasible, volunteer services shall be supported by the same methods that the organization uses to support the allocability of its regular personnel costs.

(e) *Special standards for third-party in-kind contributions.* (1) Third-party in-kind contributions shall count towards satisfying a cost-sharing or matching requirement only where, if the party receiving the contributions were to pay for them, the payments would be allowable costs.

(2) A third-party in kind contribution shall not count as direct cost sharing or matching where, if the party receiving the contribution were to pay for it, the payment would be an indirect cost. Cost-sharing or matching credit for such contributions shall be given only if the recipient or contractor has established, along with its regular indirect cost rate, a special rate for allocating to individual projects or programs the value of the contributions. (Information on how to establish these rates can be obtained from the Division of Cost Allocation in any HHS regional office's Regional Administrative Support Center.)

(3) The values placed on third-party in-kind contributions for cost-sharing or matching purposes shall conform to the rules in the succeeding sections of this subpart. If a third-party in-kind contribution is of a type not treated in those sections, the value placed upon it shall be fair and reasonable.

§ 74.54 Valuation of donated services.

(a) *Volunteer services.* Unpaid services provided to a recipient by individuals shall be valued at rates consistent with those ordinarily paid for similar work in the recipient's organization. If the recipient does not have employees performing similar work, the rates shall be consistent with those ordinarily paid by other employers for similar work in the same labor market. In either case, a reasonable amount for fringe benefits may be included in the valuation.

(b) *Employees of other Organizations.* When an employer other than a recipient or cost-type contractor furnishes free of charge the services of an employee in the employee's normal line of work, the services shall be valued at the employee's regular rate of pay exclusive of the employer's fringe benefits and overhead costs. If the services are in a different line of work, paragraph (a) of this section shall apply.

§ 74.55 Valuation of donated supplies and loaned equipment or space.

(a) If a third party donates supplies, the contribution shall be valued at the market value of the supplies at the time of donation.

(b) If a third party donates the use of equipment or space in a building but retains title, the contribution shall be valued at the fair rental rate of the equipment or space.

§ 74.56 Valuation of donated equipment, buildings, and land.

If a third party donates equipment, buildings, or land, and title passes to a recipient, the treatment of the donated property shall depend upon the purpose of the grant or subgrant, as follows:

(a) *Awards for capital expenditures.* If the purpose of the grant or subgrant is to assist the recipient in the acquisition of property, the market value of that property at the time of donation may be counted as cost sharing or matching.

(b) *Other awards.* If assisting in the acquisition of property is not the purpose of the grant or subgrant, the following rules apply:

(1) If approval is obtained from the awarding party, the market value at the time of donation of the donated equipment or buildings and the fair rental rate of the donated land may be counted as cost sharing or matching. In the case of a subgrant, the terms of the HEW grant may require that the approval be obtained from the granting agency as well as the grantee. In all cases, the approval may be given only if a purchase of the equipment or rental of the land would be approved as an allowable direct cost.

(2) If approval is not obtained under paragraph (b)(1) of this section, no amount may be counted for donated land, and only depreciation or use allowances may be counted for donated equipment and buildings. The depreciation or use allowances for this property are not treated as third-party in-kind contributions. Instead, they are treated as costs incurred by the recipient. They are computed and allocated (usually as indirect costs) in accordance with the cost principles specified in subpart Q of this part, in the same way as depreciation or use allowances for purchased equipment and buildings. The amount of depreciation or use allowances for donated equipment and buildings is based on the property's market value at the time it was donated.

§ 74.57 Appraisal of real property.

In some cases under §§ 74.55 and 74.56, it will be necessary to establish the market value of land or a building or the fair rental rate of land or of space in a building. In these cases, the granting agency may

require that the market value or fair rental rate be established by a certified real property appraiser (or by a representative of the U.S. General Services Administration, if available) and that the value or rate be certified by a responsible official of the party to which the property or its use is donated. For subgrants, this requirement may also be imposed by the grantee.

SUBPART H

Standards for Grantee and Subgrantee Financial Management Systems and Audits

§ 74.60 Scope of subpart.

(a) This subpart contains standards for financial management systems and non-Federal audits of recipients.

(b) Awarding parties may not impose on recipients additional financial management standards or requirements concerning non-Federal audits. They may, however, provide recipients with suggestions and assistance on these subjects.

§ 74.61 Financial Management Standards.

Grantees and subgrantees shall meet the following standards for their grant and subgrant financial management systems.

(a) *Financial reporting.* Accurate, current, and complete disclosure of the financial results of each project or program shall be made in accordance with the financial reporting requirements of the grant or subgrant. The terms of grants and subgrants shall not require financial reporting on the accrual basis if the recipient's accounting system is maintained on the cash basis. When accrual reporting is statutorily required, a recipient whose accounting system is not maintained on that basis shall not be required to convert it to the accrual basis; the recipient may develop the accrual information through an analysis of the documentation on hand.

(b) *Accounting records.* Records which identify adequately the source and application of funds for grant- or subgrant-supported activities shall be maintained. These records shall contain information pertaining to grant or subgrant awards, authorizations, obligations, unobligated balances, assets, outlays, income, and if the recipient is a government, liabilities.

(c) *Internal control.* Effective control and accountability shall be maintained for all grant or subgrant cash, real and personal property covered by subpart O of this part, and other assets. Recipients shall adequately safeguard all such property and shall assure that it is used solely for authorized purposes.

(d) *Budgetary control.* The actual and budgeted amounts for each grant or subgrant shall be compared. If appropriate or specifically required, recipients shall relate financial information to performance or productivity data, including the production of unit cost information. If unit cost data are required, estimates based on available documentation will be accepted whenever possible.

(e) *Advance payments.* Procedures shall be established to minimize the time elapsing between the advance of Federal grant or subgrant funds and their disbursement by the recipient. When advances are made by letter-of-credit method, the recipient shall make drawdowns as close as possible to the time of making disbursements. Grantees advancing cash to subgrantees shall conform substantially to the same standards of timing and amount as apply to advances by Federal agencies to grantees, including requirements for timely reporting of cash disbursements and balances. (See subpart K of this part.)

(f) *Allowable costs.* Procedures shall be established for determining the reasonableness, allowability, and allocability of costs in accordance with the applicable cost principles prescribed by subpart Q of this part and the terms of the grant.

(g) *Source documentation.* Accounting records shall be supported by source documentation such as cancelled checks, paid bills, payrolls, contract and subgrant award documents, etc.

(h) *Audit resolution.* Each recipient shall follow a systematic method to assure timely and appropriate resolution of audit findings and recommendations.

§ 74.62 Non-Federal Audits

(a) *Governmental recipients.* Recipients that are governments shall comply with the requirements concerning non-Federal audits in OMB Circular No. A-102, including any amendments to those requirements published in the Federal Register by OMB.[1]

(b) *All other recipients.* Recipients that are not governments shall comply with the requirements concerning non-Federal audits in OMB Circular No. A-110, including any amendments to those requirements published in the Federal Register by OMB.[1]

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[1] OMB Circulars A-102 and A-110 are available on request from the Office of Management and Budget, Publications Room, New Executive Office Building, Washington, D.C. 20503. Here is a summary of some of the main provisions concerning non-Federal audits in those two circulars:

(1) Each recipient must have itself audited by non-Federal auditors at least every two years.

(2) The recipient's auditors must meet certain standards of independence.

(3) The audit is to be performed on an organization-wide basis, with appropriate sampling of grant-related transactions. Awarding parties may not impose grant-by-grant (or subgrant-by-subgrant) audit requirements.

§ 74.70 Scope and applicability of subpart.

(a) This subpart prescribes requirements and forms for grantees to report financial information to HHS and to request grant payments when a letter of credit is not used.

(b) This subpart need not be applied by grantees in dealing with their subgrantees. However, grantees are encouraged not to impose on subgrantees more burdensome requirements than HHS imposes on grantees.

§74.71 Definitions.

As used in this subpart or in the forms identified by this subpart:

"Accrued expenditures" are the charges by grantee during a given period requiring the provision of funds for: (a) goods and other tangible property received; (b) services performed by employees, contractors, subgrantees, and other payees; and (c) amounts "becoming owed" for which no current services or performance is required, such as annuities, insurance claims, and other benefit payments.

"Accrued income" is the sum of (a) earnings during a given period from services performed by the grantee and from goods and other tangible property delivered to purchasers, and (b) amounts "becoming owed" to the grantee for which no current services or performance is required by the grantee.

"Federal funds authorized" means the total amount of Federal funds obligated by the Federal Government and authorized for use by the grantee.

"In-kind contributions" means "third-party in-kind contributions" as defined in subpart G of this part.

"Obligations" are the amounts of orders placed, contracts and subgrants awarded, services received, and similar transactions during a given period, which will require payment during the same or a future period.

"Outlays" are charges made to the grant project or program. Outlays may be reported on a cash or accrual basis.

"Program income" has the same meaning it has in subpart F of this part.

"Unobligated balance" is the portion of the Federal funds authorized which has not been obligated by the grantee and is determined by deducting the grantee's cumulative obligations from the cumulative Federal funds authorized.

"Unliquidated obligations," for reports prepared on a cash basis, are the amount of obligations incurred by the grantee that has not been paid. For reports prepared on an accrued expenditure basis, they are the amount of obligations incurred by the grantee for which an outlay has not been recorded.

§ 74.72 General

(a) Except as provided in paragraphs (d) and (e) of this section, grantees shall use only the forms specified in §§ 74.73 through 74.76, and such supplementary or other forms as may from time to time be authorized by OGP, for:

(1) Submitting grant financial reports to granting agencies, or

(2) Requesting advances or reimbursements when letters of credit are not used.

(b) Grantees shall follow all applicable standard instructions issued by OMB for use in connection with the forms specified in §§ 74.73 through 74.76. Granting agencies may issue substantive supplementary instructions only with the approval of OGP. Granting agencies may shade out or instruct the grantee to disregard any line item that the granting agency finds unnecessary for its decision making purposes.

(c) Grantees will not be required to submit more than the original and two copies of forms required under this subpart.

(d) Granting agencies may provide computer outputs to grantees to expedite or contribute to the accuracy of reporting. Granting agencies may accept the required information from grantees in machine usable format or computer printouts instead of prescribed formats.

(e) When a granting agency has determined that a grantee's accounting system does not meet the standards for financial management systems contained in subpart H of this part, it may require financial reports with more frequency or more detail (or both), upon written notice to the grantee (without regard to § 74.7), until such time as the standards are met.

(f) HHS may waive any report required by this subpart if not needed.

(g) Granting agencies may extend the due date for any financial report upon receiving a justified request from the grantee.

§ 74.73 Financial Status Report.

(a) *Form.* Grantees shall use Standard Form 269, Financial Status Report, to report the Status of funds for all nonconstruction grants.

(b) *Accounting basis.* Each grantee shall report program outlays and program income on the same accounting basis, i.e., cash or accrued expenditure (accrual), which it uses in its accounting system.

(c) *Frequency.* The granting agency may prescribe the frequency of the report for each project or program. However, the report shall not be required more frequently than quarterly except as provided in §§ 74.7 and 74.72(e). If the granting agency does not specify

the frequency of the report, it shall be submitted annually. A final report shall be required upon expiration or termination of grant support.

(d) *Due date.* When reports are required on a quarterly or semiannual basis, they shall be due 30 days after the reporting period. When required on an annual basis, they shall be due 90 days after the grant year. Final reports shall be due 90 days after the expiration or termination of grant support.

§ 74.74 Federal Cash Transactions Report.

(a) *Form.* (1) For grants paid by letters of credit (or Treasury check advances) through any HHS payment office except the Departmental Federal Assistance Financing System (DFAFS), the grantee shall submit to the payment office Standard Form 272, Federal Cash Transactions Report, and when necessary, its continuation sheet, Standard Form 272a. For grants paid by DFAFS, the grantee shall submit DFAFS Report 27, Recipient Report of Expenditures, to DFAFS.

(2) These reports will be used by the HHS payment office to monitor cash advanced to grantees and to obtain disbursement or outlay information for each grant from grantees. The format of the report may be adapted as appropriate when reporting is to be accomplished with the assistance of automatic data processing equipment: *Provided,* that the information to be submitted is not changed in substance.

(b) *Forecasts of Federal cash requirements.* Forecasts of Federal cash requirements may be required in the "Remarks" section of the report.

(c) *Cash in hands of secondary recipients.* When considered necessary and feasible by the responsible HHS payment office, grantees may be required to report the amount of cash subadvances in excess of three days' needs in the hands of their subgrantees or contractors and to provide short narrative explanations of actions taken by the grantee to reduce the excess balances.

(d) *Frequency and due date.* Grantees shall submit the report no later than 15 working days following the end of each quarter. However, where a letter of credit authorizes advances at an annualized rate of one million dollars or more, the HHS payment office may require the report to be submitted within 15 working days following the end of each month.

§ 74.75 Request for Advance or Reimbursement.

(a)(1) *Advance payments.* Requests for Treasury check advance payments shall be submitted on Standard Form 270, Request for Advance or Reimbursement. (This form is not used for drawdowns under a letter of credit or when Treasury check advance payments are made to the grantee automatically on a predetermined basis.)

(2) *Reimbursements.* Requests for reimbursement under non-construction grants shall also be submitted on Standard Form 270. (For reimbursement requests under construction grants, see § 74.76(a).)

(b) The frequency for submitting payment requests is treated in § 74.96.

§ 74.76 Outlay Report and Request for Reimbursement for Construction Programs.

(a) *Construction grants paid by reimbursement method.* (1) Requests for reimbursement under construction grants shall be submitted on Standard Form 271, Outlay Report and Request for Reimbursement for Construction Programs. Granting agencies may, however, prescribe the Request for Advance or Reimbursement form specified in § 74.75 instead of this form.

(2) The frequency for submitting reimbursement requests is treated in § 74.96.

(b) *Construction grants paid by letter of credit or Treasury check advance.* (1) When a construction grant is paid by letter of credit or Treasury check advances, the grantee shall report its outlays to the granting agency using Standard Form 271, Outlay Report and Request for Reimbursement for Construction Programs. The granting agency will provide any necessary special instruction. However, frequency and due date shall be governed by § 74.73(c) and (d).

(2) When a construction grant is paid by Treasury check advances based on periodic requests from the grantee, the advances shall be requested on the form specified in § 74.75.

(3) The granting agency may substitute the Financial Status Report specified in § 74.73 for the Outlay Report and Request for Reimbursement.

(c) *Accounting basis.* The accounting basis for the Outlay Report and Request for Reimbursement for Construction Programs shall be governed by § 74.73 (b).

SUBPART J
Monitoring and Reporting of Program Performance

§ 74.80 Scope of subpart.

This subpart sets forth the procedures for monitoring and reporting program performance of recipients. These procedures are designed to place reliance on recipients to manage the day-to-day operations of their grant- and subgrant-supported activities.

§ 74.81 Monitoring by recipients.

Recipients shall monitor the performance of grant- and subgrant-supported activities. They shall review each program, function, or activity to assure that adequate progress is being made towards achieving the goals of the grant or subgrant.

§ 74.82 Performance reports under non-construction grants.

(a) Where the granting agency determines that performance information sufficient to meet its programmatic needs will be available from subsequent applications, the granting agency will require the grantee to submit a performance report only upon expiration or termination of grant support. This report will be due on the same date as the final Financial Status Report unless waived by the granting agency. Note that the "Application for Federal Assistance (Nonconstruction Programs)" prescribed by subpart N of this part, when used to request continued support, provides information substantially equivalent to a performance report.

(b) Except as provided in paragraph (a) of this section, grantees shall submit annual performance reports unless the granting agency requires quarterly or semiannual reports. Annual reports shall be due 90 days after the grant year; qurterly or seminnual reports shall be due 30 days after the reporting period. A final performance report shall be due 90 days after the expiration or termination of grant support. Granting agencies may extend the due date for any performance report upon receiving a justified request from the grantee. In addition, granting agencies may waive the requirement for any performance report which is not needed.

(c) The content of performance reports shall conform to any instructions issued by the granting agency, including, to the extent appropriate to the particular grant, a brief presentation of the following for each program, function, or activity involved:

(1) A comparison of actual accomplishments to the goals established for the period. Where the output of the project or program can be readily expressed in numbers, a computation of the cost per unit of output may be required if that information will be useful.

(2) The reasons for slippage if established goals were not met.

(3) Other pertinent information including, when appropriate, analysis and explanation of unexpectedly high overall or unit costs.

(d) Grantees will not be required to submit more than the original and two copies of performance reports.

(e) Grantees shall adhere to the standards in paragraphs (a) through (d) of this section in prescribing performance reporting requirements for subgrantees.

§ 74.83 Performance reports under construction grants.

In general, awarding parties rely heavily on on-site technical inspection and certified percentage-of-completion data to keep themselves informed as to progress under construction grants and subgrants. Formal performance reports to supplement those sources of information shall be required only if considered necessary by the awarding party, and in no case more frequently than quarterly.

§ 74.84 Significant developments between scheduled reporting dates.

Between the scheduled performance reporting dates, events may occur which have significant impact upon the grant- or subgrant-supported activity. In such cases, the recipient shall inform the awarding party as soon as the following types of conditions become known:

(a) Problems, delays, or adverse conditions which will materially impair the ability to attain the objective of the award. This disclosure shall be accompanied by a statement of the action taken, or contemplated, and any assistance needed to resolve the situation.

(b) Favorable developments which enable meeting time schedules and goals sooner or at less cost than anticipated or producing more beneficial results than originally projected.

§ 74.85 Site visits.

Site visits may be made as necessary by representatives of HHS to:

(a) Review program accomplishments and management control systems.

(b) Provide such technical assistance as may be required.

SUBPART K
Grant and Subgrant Payment Requirements

§ 74.90 Scope of subpart.

This subpart prescribes the basic standard and the methods under which HHS will make grant payments to grantees, and grantees will make subgrant payments to their subgrantees.

§ 74.91 Definitions.

As used in this subpart:

"Advance by Treasury check" is a payment made by a Treasury check to a grantee, upon its periodic request or through the use of predetermined payment schedules, before payments are made by the grantee.

"Letter of credit" is an instrument certified by an authorized official which authorizes a recipient to draw funds needed for immediate disbursement in accordance with Treasury Circular No. 1075.

"Percentage of completion method" refers to a system under which payments are made for construction work according to the percentage of completion of the work, rather than to the grantee's rate of disbursements.

§ 74.92 Basic standard.

Methods and procedures for making payments to recipients shall minimize the time elapsing between the transfer of funds and the recipient's disbursements.

§ 74.93 Payment methods under nonconstruction grants.

(a) Letters of credit will be used to pay HHS grantees when all of the following conditions exist:

(1) There is or will be a continuing relationship between the grantee and the HHS payment office for at least a year and the total amount of advances to be received from the HHS payment office is $120,000 or more per year.

(2) The grantee has maintained, or demonstrated to HEW the willingness and ability to maintain, procedures that minimize the time elapsing between the transfer of funds from the Treasury and their disbursement by the grantee, and

(3) The grantee's financial management system meets the standards for fund control and accountability in Subpart H of this part.

(b) Advances by Treasury check will be used, in accordance with Treasury Circular No. 1075, when the grantee does not meet the requirements in paragraph (a)(1) of this section but does meet the requirements in paragraphs (a)(2) and (3) of this section.

(c) Reimbursement by Treasury check will be preferred method when the requirements of either paragraph (a)(2) or paragraph (a)(3) of this section are not met. This method may also be used when the major portion of the program is accomplished through private market financing or Federal loans, and the Federal grant assistance constitutes a minor portion of the program.

§ 74.94 Payment methods under construction grants.

(a) Reimbursement by Treasury check shall be the preferred method when the grantee does not meet the requirements specified in § 74.93 (a) (2) or (3), and may be used for any HHS construction grant unless HHS has entered into an agreement with the grantee to use a letter of credit for all HHS grants, including construction grants.

(b) When the reimbursement by Treasury check method is not used, § 74.93 (a) and (b) shall apply to the construction grant. Implementing procedures under § 74.93 (a) and (b) will be insofar as possible the same for construction grants as for nonconstruction grants awarded to the same grantee.

(c) HHS will not use the percentage of completion method to pay its construction grants. The grantee may use that method to pay its construction contractor, but if it does, HHS's payments to the grantee will nevertheless be based on the grantee's actual rate of disbursements.

§ 74.95 Withholding of payments.

(a) Unless otherwise required by Federal statute, payments for proper charges incurred by grantees will not be withheld unless (1) the grantee has failed to comply with Federal reporting requirements or (2) the grant is suspended pursuant to § 74.114 or (3) the grantee owes money to the United States and collection of the debt by withholding grant payments will not impair the accomplishment of the objectives of any grant program sponsored by the United States.

(b) Cash withheld for failure to comply with reporting requirements but without suspension of the grant will be released to the grantee upon subsequent compliance. When a grant is suspended, payment adjustments will be made in accordance with § 74.114. When a debt is to be collected, HHS may withhold payments or require appropriate accounting adjustments to recorded grant cash balances for which the grantee is accountable to the Federal Government, in order to liquidate the indebtedness.

§ 74.96 Requesting advances or reimbursements.

(a) If advances are made by Treasury check and the advances are not prescheduled, the grantee shall

submit its requests for payment monthly. Less frequent requests are not permitted because they would result in advances covering excessive periods of time The grantee shall not request advances in excess of the Federal share of reasonable estimates of its outlays for the month covered. The grantee shall make these estimates on a cash basis, even if it uses an accrual accounting system.

(b) If payments are made through reimbursement by Treasury check:

(1) The grantee may submit its requests for reimbursement monthly and may submit them more often if authorized. The grantee will be paid as promptly as possible, odinarily within 30 days after receipt of a proper request for reimbursement.

(2) The grantee shall not request reimbursement for the Federal share of amounts withheld from contractors to ensure satisfactory completion of work until after it makes those payments. To meet this requirement, a grantee with an accural accounting system need not convert to cash basis accounting. It may bill in general on an accrued cost basis, handling these retained amounts as adjustments in the billing system.

(c) The forms for requesting advances or reimbursements are identified in subpart I of this part.

§ 74.97 Payments to subgrantees.

Grantees shall observe the requirements of this subpart in making (or withholding) payments to subgrantees, with the following exceptions:

(a) Advance payment by check may be used instead of letter of credit;

(b) The forms specified in subpart I of this part for requesting advances and reimbursements are not required to be used by subgrantees; and

(c) The reimbursement by check method may be used to pay any construction subgrant, whether or not HHS has agreed to use a letter of credit for all direct HHS grants to that same recipient.

SUBPART L
Programatic Changes and Budget Revisions

§ 74.100 Scope and applicability of this subpart.

(a) *Scope.* This subpart deals with prior approval requirements for post-award programmatic changes and budget revisions by recipients.

(b) *Exemption of mandatory grants.* Sections 74.103 through 74.106 do not apply to programmatic changes or budget revisions made by grantees under State plan or other grants which the granting agency is required by law to award if the applicant meets all applicable requirements for entitlement. (These are generally called "mandatory" or "formula" grants.)

(c) *Exemption of certain subgrants.* Sections 74.103 through 74.106 do not apply to subgrants from States to their local governments under a mandatory or formula grant, if the local government is not required to apply for the subgrant on a project basis. Generally, such exempt subgrants will occur under a State plan which provides for local administration of a State-wide program under State supervision.

§ 74.101 Relationship to cost principles.

The cost principles in Appendices C, D, E, and F to this part contain requirements for prior approval of certain types of costs (see § 74.176). Except when waived, those requirements apply to all grants and subgrants even if §§ 74.103 through 74.106 do not.

§ 74.102 Prior approval procedures.

(a) *For grants.* When requesting a prior approval required by this subpart, grantees shall address their requests to the responsible grants officer of the granting agency. Approvals shall not be valid unless they are in writing and signed by either the grants officer, the head of the granting agency, or the head of the granting agency's regional office.

(b) *For subgrants.* Grantees shall be responsible for reviewing requests from their subgrantees for the approvals required by this subpart and for giving or denying the approval. A grantee shall not approve any action which is inconsistent with the purpose or terms of the Federal grant. If an action by a subgrantee will result in a change in the overall grant project or budget requiring granting agency approval, the grantee shall obtain that approval before giving its approval to the subgrantee. Approvals shall not be valid unless they are in writing and signed by an authorized official of the grantee.

(c) *Timing.* Within 30 days from the date of receipt of a request for approval, the approval authority shall review the request and notify the recipient of its decision. If the request for approval is still under consideration at the end of 30 days, the approval authority shall inform the recipient in writing as to when to expect the decision.

§ 74.103 Programmatic changes.

(a) *Scope.* This section contains requirements for prior approval of departures, other than budget revisions, from approved project plans. In addition to the requirements in this section, awarding parties may require prior approval for other kinds of programmatic changes to an approved grant or subgrant project.

(b) *Changes to project scope or objectives.* The recipient shall obtain prior approval for any change to the scope or objectives of the approved project. (For construction projects, any material change in approved space utilization or functional layout shall be considered a change in scope.)

(c) *Changes in key people.* The recipient of a grant or subgrant for research (or any other kind of grant or subgrant if the terms of the award make this rule applicable) shall obtain prior approval:

(1) To continue the project during any continuous period of more than 3 months without the active direction of an approved project director or principal investigator; or

(2) To replace the project director or principal investigator (or any other persons named and expressly identified as key project people in the notice of grant or subgrant award) or to permit any such people to devote substantially less effort to the project than was anticipated when the grant or subgrant was awarded.

(d) *Other programmatic changes.* The following shall require prior approval except to the extent explicitly included in the project plan as approved by the awarding party at the time of award:

(1) Provinding financial assistance to a third party by subgranting or any other means.

(2) Transferring to a third party, by contracting or any other means, the actual performance of the substantive programmatic work. The term "substantive programmatic work" means activities which are central to carrying out the purpose of the project, and not merely incidental. Transfer of substantive programmatic work does not include purchase of supplies, materials, or equipment; acquisition of general or incidental support services; obtaining advice; or transfer of activities whose cost is treated as an indirect cost.

(3) Providing medical care to individuals under research grants.

§ 74.104 Budgets generally.

(a) *Definitions.* In this subpart:

(1) "Budget" means the recipient's financial plan for carrying out the project or program.

(2) "Approved budget" means a budget (including any revised budget) which has been approved by the awarding party.

(b) *Research project budgets.* For research projects, approved budgets shall not include the recipient's share of project costs.

(c) *Non-research project budgets.* For non-research projects which involve cost sharing or matching, approved budgets shall ordinarily consist of a single set of figures covering total project cost (the sum of the awarding party's share and the recipient's share). However, the awarding party may specify that the recipient's share not be included in the approved budget. In no case, however, shall the approved budget be in the form of a separate set of figures for each share.

(d) *Subdivision by programmatic segments.* Some grants and subgrants encompass two or more programmatic segments (such as discrete programs, projects, functions, or types of activities). In these cases, the awarding party may require that the approved budget be subdivided to show the anticipated cost of each programmatic segment.

§ 74.105 Budget revisions—nonconstruction projects.

(a) Except as provided in paragraph (b) of this section, the recipient of a grant or subgrant having an approved budget shall obtain prior approval for any budget revision which will:

(1) Involve transfer of amounts budgeted for indirect costs to absorb increases in direct costs, or

(2) Involve transfer of amounts previously budgeted for student support (tuition waivers, stipends, and other payments to or for trainees), or

(3) Result in a need for the award of additional funds, e.g., an increase in the base upon which indirect costs are calculated which will increase allocable indirect costs and result in a claim for a supplementary award.

(b) Any or all of the prior approval requirements in paragraph (a) of this section may be waived by the awarding party.

(c) Except as provided in §§ 74.107 and 74.176, other budget changes under nonconstruction grants do not require approval.

§ 74.106 Budget revisions—construction projects.

Unless provided otherwise by the terms of the grant or subgrant, revisions to construction project budgets do not require approval.

§ 74.107 Construction and nonconstruction work under the same grant or subgrant.

When a grant or subgrant provides support for both construction and nonconstruction work, the awarding party may require prior approval before any fund or budget transfers between the two types of work.

§ 74.108 Authorized funds exceeding needs.

The recipient shall notify the awarding party promptly whenever the amount of grant or subgrant authorized funds is expected to exceed needs by more than $5,000 or 5 percent of the grant or subgrant, whichever is greater. This notification will not be required under continuing grants or subgrants if the application for the next period's funding will include an estimate of what the unobligated balance of authorized funds will be at the end of the current period.

SUBPART M
Grant and Subgrant Closeout, Suspension, and Termination

§ 74.110 Definitions.

"Grant closeout" means the process by which a granting agency determines that all applicable administrative actions and all required work of the grant have been completed by the grantee and the granting agency.

"Suspension" of a grant means temporary withdrawal of the grantee's authority to obligate grant funds pending corrective action by the grantee or a decision to terminate the grant.

"Termination" of a grant means permanent withdrawal of the grantee's authority to obligate previously awarded grant funds before that authority would otherwise expire. It also means the voluntary relinquishment of that authority by the grantee. "Termination" does not include:

(a) Withdrawal of funds awarded on the basis of the grantee's underestimate of the unobligated balance in a prior period;

(b) Refusal by the granting agency to extend a grant or award additional funds (such as refusal to make a competing or noncompeting continuation, renewal, extension, or supplemental award);

(c) Withdrawal of the unobligated balance as of the expiration of a grant;

(d) Annulment, i.e., voiding, of a grant upon determination that the award was obtained fraudulently, or was otherwise illegal or invalid from inception.

§ 74.111 Closeout.

(a) Each grant shall be closed out as promptly as is feasible after expiration or termination.

(b) In closing out HHS grants, the following shall be observed:

(1) Upon request, HHS shall promptly pay the grantee for any allowable reimbursable costs not covered by previous payments.

(2) The grantee shall immediately refund or otherwise dispose of, in accordance with instructions from HHS, any unobligated balance of cash advanced to the grantee.

(3) The grantee shall submit, within 90 days of the date of expiration or termination, all financial, performance, and other reports required by the terms of the grant. HHS may extend the due date for any report upon receiving a justified request from the grantee, and may waive any report which is not needed.

(4) The granting agency shall make a settlement for any upward or downward adjustment of the Federal share of costs, to the extent called for by the terms of the grant.

(c)(1) The closeout of a grant does not affect the retention period for, or Federal rights of access to, grant records. See subpart D of this part.

(2) If a grant is closed out without audit, the granting agency retains the right to disallow and recover an appropriate amount after fully considering any recommended disallowances resulting from an audit which may be conducted later.

(3) The closeout of a grant does not affect the grantee's responsibilities with respect to property under subpart O of this part, or with respect to any program income for which the grantee is still accountable under subpart F of this part.

§ 74.112 Amounts payable to the Federal Government.

For each grant, the following sums shall constitute a debt or debts owed by the grantee to the Federal Government, and shall, if not paid upon demand, be recovered from the grantee or its successor or assignees by setoff or other action as provided by law:

(a) Any grant funds paid to the grantee by the Federal Government in excess of the amount to which the grantee is finally determined to be entitled under the terms of the grant;

(b) Any interest or other investment income earned on advances of grant funds which is due the Federal Government pursuant to § 74.47;

(c) Any royalties or other special classes of program income which, under the terms of the grant, are required to be remitted to the Federal Government

(see subpart F of this part);

(d) Any amounts due the Federal Government under subpart O of this part; and

(e) Any other amounts finally determined to be due the Federal Government under the terms of the grant.

§ 74.113 Violation of terms.

(a) When a grantee has materially failed to comply with the terms of a grant, the granting agency may suspend the grant, in accordance with §74.114, terminate the grant for cause, as provided in § 74.115, or take such other remedies as may be legally available and appropriate in the circumstances.

(b) If a project or program is supported over two or more funding periods, a grant may be suspended or terminated in the current period for failure to submit a report still due from a prior period.

§ 74.114 Suspension.

(a) When a grantee has materially failed to comply with the terms of a grant, the granting agency may, upon reasonable notice to the grantee, suspend the grant in whole or in part. The notice of suspension will state the reasons for the suspension, any corrective action required of the grantee, and the effective date. The suspension may be made effective at once if a delayed effective date would be unreasonable considering the granting agency's responsibilities to protect the Federal Government's interest. Suspensions shall remain in effect until the grantee has taken corrective action satisfactory to the granting agency, or given evidence satisfactory to the granting agency that such corrective action will be taken, or until the granting agency terminates the grant.

(b) New obligations incurred by the grantee during the suspension period will not be allowed unless the granting agency expressly authorizes them in the notice of suspension or an amendment to it. Necessary and otherwise allowable costs which the grantee could not reasonably avoid during the suspension period will be allowed if they result from obligations properly incurred by the grantee before the effective date of the suspension and not in anticipation of suspension or termination. At the discretion of the granting agency, third-party in-kind contributions applicable to the suspension period may be allowed in satisfaction of cost sharing or matching requirements.

(c) Appropriate adjustments to payments under the suspended grant will be made either by withholding subsequent payments or by not allowing the grantee credit for disbursements made in payment of unauthorized obligations incurred during the suspension period.

§ 74.115 Termination.

(a) *Termination for cause.* The granting agency may terminate any grant in whole, or in part, at any time before the date of expiration, whenever it determines that the grantee has materially failed to comply with the terms of the grant. The granting agency shall promptly notify the grantee in writing of the determination and the reasons for the termination, together with the effective date.

(b) *Termination on other grounds.* Except as provided in paragraph (a) of this section, grants may be terminated in whole or in part only as follows:

(1) By the granting agency with the consent of the grantee, in which case the two parties shall agree upon the termination conditions, including the effective date and in the case of partial termination, the portion to be terminated, or

(2) By the grantee, upon written notification to the granting agency, setting forth the reasons for such termination, the effective date, and in the case of partial termination, the portion to be terminated. However, if, in the case of a partial termination, the granting agency determines that the remaining portion of the grant will not accomplish the purposes for which the grant was made, the granting agency may terminate the grant in its entirety under either paragraph (a) or paragraph (b)(1) of this section.

(c) *Termination settlements.* When a grant is terminated, the grantee shall not incur new obligations for the terminated portion after the effective date, and shall cancel as many outstanding obligations as possible. The granting agency shall allow full credit to the grantee for the Federal share of the noncancellable obligations properly incurred by the grantee prior to termination.

§ 74.116 Applicability to subgrants.

Grantees shall adhere to the same standards regarding closeout, suspension, and termination of subgrants as are prescribed in this subpart for granting agencies.

SUBPART N
Forms for Applying for Grants

§ 74.120 Scope of subpart.

(a) This subpart prescribes forms and instructions to be used by governmental organizations (except hospitals and institutions of higher education operated by a government) in applying to HHS for grants. This subpart is not applicable, however, to mandatory or formula grant programs which do not require applicants to apply to HHS for funds on a project basis.

(b) This subpart permits granting agencies to prescribe the form of applications by nongovernmental organizations (including hospitals and institutions of higher education operated by a government), but

prescribes the use of a standard facesheet for certain of these applications.

(c) This subpart applies only to applications for grants, and is not required to be applied by grantees in dealing with applicants for subgrants. However, grantees are encouraged not to adopt more detailed or burdensome application requirements for subgrants.

§ 74.121 Authorized forms and instructions for governmental organizations.

(a) In applying to HHS for grants, governments shall use only the forms specified in §§ 74.122 through 74.126, and such supplementary or other forms as may from time to time be prescribed by the granting agency with the approval of OGP.

(b) Governments will not be required to submit more than the original and two copies of their applications.

(c) Governments shall follow all applicable standard instructions promulgated by OMB for use in connection with the forms specified in §§ 74.122 through 74.126. Granting agencies may specify and describe the programs, functions, or activities that will be used to plan, budget, and evaluate the work under a grant. Other supplementary instructions may be issued only with the approval of OGP. For any form, the granting agency may shade out or instruct the applicant to disregard any line item that is not needed.

(d) When a government applies for additional funding (such as a continuation or supplemental award) or amends a previously submitted application, only the facesheet and any other affected pages need be submitted. Previously submitted pages whose information is still current need not be resubmitted.

§ 74.122 Preapplications for Federal Assistance for governmental organizations.

(a) When a preapplication is submitted by a government, the preapplication for Federal assistance form prescribed by OMB Circular A–102 shall be used. The purposes of preapplications shall be to:

(1) Establish communication between the applicant and the granting agency;

(2) Determine the applicant's eligibility;

(3) Determine how well the project can compete with similar applications from others in order to discourage proposals which have little or no chance for Federal funding before applicants incur significant expenditures for preparing an application.

(b) Preapplication shall be mandatory when the potential applicant is a government and the proposed project (1) is for construction, land acquisition, or land development, and (2) would require more than $100,000 of Federal funding. The granting agency may require preapplications regardless of the type of project and regardless of the estimated amount of Federal funding. In addition, any government may submit a preapplication even when not required by the granting agency.

§ 74.123 Notice of preapplication review action for governmental organizations.

The notice of preapplication review action form prescribed by attachment M of OMB Circular No. A–102 will be used by granting agencies to inform governmental applicants of the results of the review of the preapplications submitted to them. The granting agency will send a notice to the applicant ordinarily within 45 days of the receipt of the preapplication form. If the review cannot be made within 45 days, the applicant will be informed by letter as to when the review will be completed.

§ 74.124 Applications for Federal assistance (nonconstruction programs) for governmental organizations.

The applicant for Federal assistance (nonconstruction programs) form prescribed by attachment M of OMB Circular No. A–102 shall be used by governments in applying for any grant to which this subpart is applicable except where a form specified in § 74.125 or § 74.126 is to be used.

§ 74.125 Application for Federal assistance (for construction programs) for governmental organizations.

The applicant for Federal assistance (for construction programs) form prescribed by attachment M of OMB Circular No. A–102 shall be used by governments in applying for any grant whose purpose is solely or primarily construction, land acquisition, or land development.

§ 74.126 Application for Federal assistance (short form) for governmental organizations.

The applicant for Federal assistance (short form) form prescribed by attachment M of OMB Circular No. A–102 shall be used by governments in applying for any single-purpose one-time grant of less than $10,000 not requiring clearinghouse review, an environmental impact statement, or the relocation of persons, businesses, or farms. Granting agencies may, at their discretion, authorize or prescribe this form for applications for larger amounts.

§ 74.127 Authorized forms and instructions for nongovernmental organizations.

Nongovernmental organizations shall use application forms and instructions prescribed by the granting agency, except that the facesheet of such applications shall be standard form 424 for grants under programs covered by attachment A. part I, of OMB Circular No. A–95.

SUBPART O
Property

GENERAL

§ 74.130 Scope and applicabiliy of this subpart.

(a) Except as explained in paragraphs (c), (d), and (e) of this section this subpart applies to real property, equipment, and supplies acquired with grant support. To be considered acquired with grant support, some or all of the property's acquisition cost must be a direct cost under the grant, a subgrant, or a cost-type contract and must be either borne by grant funds or counted toward satisfying a grant cost-sharing or matching requirement.

(b) This subpart also deals with inventions, patents, and copyrights arising out of activities assisted by a grant or subgrant.

(c) This subpart does not apply to—

(1) Property for which only depreciation or use allowances are charged;

(2) Property donated entirely as a third-party in-kind contribution (as defined in § 74.51); or

(3) Equipment or supplies acquired primarily for sale or rental rather than for use.

(d) Equipment or supplies acquired by a contractor under a grant or subgrant shall be subject to this subpart only if, by terms of the contract, title vests in the grantee or subgrantee.

(e) For research grants that are subject to an institutional cost-sharing agreement (see § 74.50(b)), real property, equipment, and supplies shall be subject to this subpart only if at least some part of the acquisition cost is borne as a direct cost by Federal grant funds.

§ 74.131 Prohibition against additional requirements.

Recipients may follow their own property management policies and procedures: *Provided,* They observe the requirements of this subpart. Awarding parties may not impose on recipients property requirements (including property reporting requirements) not authorized by this subpart unless specifically required by Federal statutes or Executive Orders.

§ 74.132 Definitions.

As used in this subpart:

"Acquisition" of property includes purchase, construction, or fabrication of property, but does not include rental of property or alterations and renovations of real property.

"Acquisition cost" of an item of purchased equipment means the net invoice price of the equipment, including the cost of modifications, attachments, accessories, or auxiliary apparatus necessary to make the equipment usable for the purpose for which it was acquired. Other charges such as the cost of installation, transportation, taxes, duty or protective in-transit insurance shall be included in or excluded from the unit acquisition cost in accordance with the regular accounting practices of the organization purchasing the equipment. If the item is acquired by trading in another item and paying an additional amount, "acquisition cost" means the amount received for trade-in plus the additional outlay.

"Amount received for trade-in" of an item of equipment traded in for replacement equipment means the amount that would have been paid for the replacement equipment without a trade-in minus the amount paid with the trade-in. The term refers to the actual difference, not necessarily the trade-in value shown on an invoice.

"Equipment" means an article of tangible personal property that has a useful life of more than two years and an acquisition cost of $500 or more. Any recipient may use its own definition of equipment if its definition would at least include all items of equipment as defined here.

"Personal property" means property of any kind except real property. It may be tangible—having physical existence, or intangible—having no physical existence, such as patents, inventions, and copyrights.

"Real property" means land, including land improvements, structures and appurtenances thereto, but excluding movable machinery and equipment.

"Replacement equipment" means property acquired to take the place of other equipment. To qualify as replacement equipment, it must serve the same function as the equipment replaced and must be of the same nature or character, although not necessarily the same model, grade, or quality.

"Supplies" means all tangible personal property other than equipment.

§ 74.133 Title to real property, equipment, and supplies.

Subject to the obligations and conditions set forth in this subpart, title to real property, equipment, and supplies acquired under a grant or subgrant shall vest, upon acquisition, in the grantee or subgrantee respectively.

REAL PROPERTY

§ 74.134 Real property.

Except as otherwise provided by federal statutes, real property to which this subpart applies shall be subject to the following requirements, in addition to any other requirements imposed by the terms of the grant:

(a) *Use.* The property shall be used for the originally authorized purpose as long as needed for that purpose. When no longer so needed, approval of the granting agency may be requested to use the property for other purposes. Use for other purposes shall be limited to:

(1) Projects or programs supported by other Federal grants or assistance agreements.

(2) Activities not supported by other Federal grants or assistance agreements but having, nevertheless, purposes consistent with those of the legislation under which the original grant was made.

(b) *Transfer of title.* Approval may be requested from the granting agency to transfer title to an eligible third party for continued use for authorized purposes in accordance with paragraph (a) of this section. If approval is permissible under Federal statutes and is given, the terms of the transfer shall provide that the transferee shall assume all the rights and obligations of the transferor set forth in this subpart or in other terms of the grant or subgrant.

(c) *Disposition.* When the real property is no longer to be used as provided in paragraphs (a) and (b) of this section, the disposition instructions of the granting agency shall be followed. Those instructions will provide for one of the following alternatives:

(1) The property shall be sold and the Federal Government shall be paid an amount computed by multiplying the Federal share of the property (see § 74.142) times the proceeds from sale (after deducting actual and reasonable selling and fix-up expenses, if any, from the sales proceeds). Proper sales procedures shall be used that provide for competition to the extent practicable and result in the highest possible return.

(2) The recipient shall have the option either of selling the property in accordance with paragraph (c)(1) of this section or of retaining title. If title is retained, the Federal Government shall be paid an amount computed by multiplying the market value of the property by the Federal share of the property.

(3) The recipient shall transfer the title to either the Federal Government or an eligible non-Federal party named by the granting agency. The grantee shall be entitled to be paid an amount computed by multiplying the market value of the property by the non-Federal share of the property. If the property belonged to a subgrantee, see § 74.143 for subgrantee's share.

EQUIPMENT AND SUPPLIES

§ 74.135 Exemptions for equipment and supplies subject to certain statutes.

(a) Some Federal statutes, in certain circumstances, permit title to equipment or supplies acquired with grant funds to vest in the recipient without further obligation to the Federal Government or on such terms and conditions as deemed appropriate. An example of such a statute is the Federal Grant and Cooperative Agreement Act of 1977, Pub. L. 95-224, which provides this authority for equipment and supplies purchased with the funds of grants (and Federal contracts and cooperative agreements) for the conduct of basic or applied scientific research at nonprofit institutions of higher education or at nonprofit organizations whose primary purpose is the conduct of scientific research.

(b) If equipment is subject to a statute of the kind described in paragraph (a) of this section, it shall be exempt from the requirements in the remaining sections of this subpart. However, an item of such equipment having a unit acquisition cost of $1,000 or more shall be subject to § 74.136, concerning rights to require transfer, and, while subject to such a right, to the rules on replacement in § 74.138.

(c) If supplies are subject to a statute of the kind described in paragraph (a) of this section, they shall be exempt from all provisions of the remainder of this subpart which would otherwise apply.

§ 74.136 Rights to require transfer of equipment.

(a) *HHS right.* For items of equipment having a unit acquisition cost of $1,000 or more, the granting agency shall have the right to require transfer of the equipment (including title) to the Federal Government or to an eligible non-Federal party named by the granting agency. This right will normally be exercised by HHS granting agencies only if the project or program for which the equipment was acquired is transferred from one grantee to another. The right shall be subject to the following conditions:

(1) In order for the granting agency to exercise the right, a specific notice that it is exercising the right or considering doing so must be issued no later than the 120th day after the end of HHS grant support for the project or program for which the equipment was acquired. Furthermore:

(i) If the equipment, is eligible for the exemptions in § 74.135 and ceases to be needed for the project or

program for which it was acquired while the project or program is still being performed by the recipient, the notice must have been received by the grantee while the equipment was still needed for that project or program.

(ii) If the equipment is not eligible for those exemptions, the notice must have been received by the grantee before other permissible disposition of the equipment took place in accordance with § 74.139.

(2) If the right is exercised, the grantee shall be entitled to be paid any reasonable, resulting shipping or storage costs incurred, plus an amount computed by multiplying the market value of the equipment by the non-Federal share of the equipment. (See §§ 74.142 and 74.143.)

(b) *Right of parties awarding subgrants.* When a grantee awards a subgrant, it may reserve for itself a right similar to that in paragraph (a) of this section for items of equipment having a unit acquisition cost of $1,000 or more which are acquired under that subgrant. Without the approval of the granting agency, the right may be exercised only if the project or program for which the equipment was acquired is transferred to another subgrantee and only for the purpose of transfering the equipment to the new subgrantee for continued use in the project or program.

(c) *Equipment lists.* If at any time an awarding party is considering exercising its right to require transfer of equipment, it may require the recipient to furnish it a list of all items of equipment that are subject to the right. This will enable the awarding party to determine which items, if any, should be transferred.

§ 74.137 Use of equipment.

(a) *Basic rule.* Equipment which has not been transferred under § 74.136 shall be used by the recipient in the project or program for which it was acquired as long as needed, whether or not the project or program continues to be supported by Federal funds. When no longer needed for the original project or program, the recipient shall use the equipment, if needed, in other projects or programs currently or previously sponsored by the Federal Government, in the following order of priority:

(1) Projects or programs currently or previously sponsored by the same granting agency.

(2) Projects or programs currently or previously sponsored by other Federal agencies.

(b) *Shared use.* If equipment is being used less than full time in the project or program for which it was originally acquired, the recipient shall make it available for use in other projects or programs currently or peviously sponsored by the Federal Government: *Provided,* Such other use will not interfere with the work on the original project or program. First preference for such other use shall be given to other projects or programs sponsored by the same granting agency.

(c) *Use by other recipients.* When the recipient can no longer use the equipment as required by paragraph (a) of this section, it may voluntarily make the equipment available for use on projects or programs currently or previously sponsored by the Federal Government which the recipient is supporting through subgrants or through non-Federal grants. If the recipient is a subgrantee, it may also voluntarily make the equipment available for use on projects or programs currently or previously sponsored by the Federal Government which are being conducted or supported by the grantee.

(d) *Other uses.* Unless the granting agency provides otherwise, while equipment is being used as described in the preceding paragraphs of this section, it may also be used part time for other purposes. However, use as described in those paragraphs shall be given priority over other uses.

§ 74.138 Replacement of equipment.

(a) Equipment may be exchanged for replacement equipment if needed. The replacement may take place either through trade-in or through sale and application of the proceeds to the acquisition cost of the replacement equipment. In either case, the transaction must be one which a prudent person would make in like curcumstances.

(b) If an additional outlay to acquire the replacement equipment is charged as a direct cost to either Federal funds or required cost-sharing or matching under a Federal award, the replacement equipment shall be subject to whatever property requirements or exemptions are applicable to that award. If the award is a grant from HHS, the full acquisition cost of the replacement equipment shall determine which provisions of this subpart apply.

(c) For any replacement not covered by paragraph (b) of this section, the provisions of this subpart applicable to the equipment replaced shall carry over to the replacement equipment. However, none of the provisions of this subpart shall carry over if (1) the Federal share of the equipment replaced was 10 percent or less or (2) the product of that share times the amount received for trade-in or sale is $100 or less.

§ 74.139 Disposition of equipment.

When original or replacement equipment is no longer to be used in projects or programs currently or previously sponsored by the Federal Government, disposition of the equipment shall be made as follows:

(a) *Equipment with a unit acquisition cost of less than $1,000 and equipment with no further use value.* The equipment may be retained, sold, or otherwise disposed of, with no further obligation to the Federal Government.

(b) *All other equipment.* (1) The equipment may be retained or sold, and the Federal Government shall have a right to an amount calculated by multiplying the current market value or the proceeds from sale by the Federal share of the equipment (see § 74.142). If part of the Federal share in the equipment came from an award under which the exemptions in § 74.135 were applicable, the amount due shall be reduced pro rata. In any case, if the equipment is sold, $100 or 10 percent of the total sales proceeds, whichever is greater, may be deducted and retained from the amount otherwise due for selling and handling expenses.

(2) If the grantee's project or program for which or under which the equipment was acquired is still receiving grant support from the same Federal program and if the granting agency approves, the net amount due may be used for allowable costs of that project or program. Otherwise, the net amount must be remitted to the granting agency by check.

§ 74.140 Equipment management requirements.

Procedures for managing equipment (including replacement equipment) until transfer, replacement, or disposition takes place shall, as a minimum, meet the following requirements:

(a) Property records shall be maintained accurately. (Retention and access requirements for these records are explained in subpart D of this part.) For each item of equipment, the records shall include:

(1) A description of the equipment including manufacturer's model number, if any.

(2) An identification number, such as the manufacturer's serial number.

(3) Identification of the grant under which the recipient acquired the equipment.

(4) The information needed to calculate the Federal share of the equipment. (See § 74.142.)

(5) Acquisition date and unit acquisition cost.

(6) Location, use, and condition of the equipment and the date the information was reported.

(7) All pertinent information on the ultimate transfer, replacement, or disposition of the equipment.

(b) A physical inventory of equipment shall be taken and the results reconciled with the property records at least once every 2 years to verify the existence, current utilization, and continued need for the equipment. A statistical sampling basis is acceptable. Any differences between quantities determined by the physical inspection and those shown in the accounting records shall be investigated to determine the causes of the differences.

(c) A control system shall be in effect to insure adequate safeguards to prevent loss, damage, or theft of the equipment. Any loss, damage, or theft of equipment shall be investigated and fully documented.

(d) Adequate maintenance procedures shall be implemented to keep the equipment in good condition.

(e) Where equipment is to be sold and the Federal Government is to have a right to part or all of the proceeds, selling procedures shall be established which will provide for competition to the extent practicable and result in the highest possible return.

§ 74.141 Unused supplies.

(a) This section applies to supplies which have not yet been put to use in the project or program for which they were acquired when the grant or subgrant under which they were acquired expires or is terminated.

(b) If the unused supplies exceed $1,000 in total aggregate fair market value and are not needed for any project or program currently or previously funded by the Federal Government, the recipient may either retain or sell the supplies, and must credit the grant as follows:

(1) **Retained supplies.** The credit is computed by multiplying the Federal share of the supplies times their current market value.

(2) **Sold supplies.** The credit is computed by multiplying the Federal share of the supplies times the proceeds from sale. However, the recipient may reduce the credit by 10% of the sales proceeds, for selling and handling expenses.

(c) For possible exemptions from this section, see § 74.135.

FEDERAL SHARE OF REAL PROPERTY, EQUIPMENT, AND SUPPLIES

§ 74.142 Federal share of property.

Several sections of this subpart require a determination of the Federal (or non-Federal) share of real property, equipment, or supplies. In making such a determination, the following principles shall be observed:

(a) *General.* (1) Except as explained in the succeeding paragraphs of this section, the Federal share of the property shall be the same percentage as the Federal share of the acquiring party's total costs under the grant during the grant or subgrant year (or other funding period) to which the acquisition cost of the property was charged. For this purpose, "costs under the grant" means allowable costs which are either borne by the grant or counted towards satisfying a cost-sharing or matching requirement of the grant. Only costs are to be counted—not the value of third-party in-kind contributions. Moreover, if the property was acquired by a grantee that awarded subgrants, costs incurred by its subgrantees shall be included only to the extent borne by the subgrants. (For example, if a subgrantee incurred $200,000 of the project costs, of which $150,000 was borne by the subgrant, only the $150,000 shall be included in the grantee's costs.)

(2) If the property is acquired by a subgrantee, the Federal share of the subgrantee s costs under the grant and hence of the property shall be calculated by multiplying the Federal share of the grantee's costs by the latter's share of the subgrantee's costs. For example,

if the Federal share of a grantee's costs is 50 percent and the subgrant bears only 50 percent of a subgrantee's costs, then the Federal share of that subgrantee's costs (and of the property acquired by that subgrantee) is 25 percent.

(b) *Property acquired only partly under a grant.* (1) Sometimes only a part of the acquisition cost of an item of property is borne as a direct cost by the grant or counted as a direct cost towards a cost-sharing or matching requirement. The remainder might, for example, represent voluntary cost sharing or matching, or it might be charged to a different activity. Occasionally, the amount paid for the property is only a part of its value, and the remainder is donated as an inkind contribution by the party that provided the property.

(2) To calculate the Federal share of such property, first determine the Federal share of the acquiring party's total costs under the grant, as explained in the paragraph (a) of this section. Then multiply that share by the percentage of the property's acquisition cost (or its market value, if the item was partly donated) which was borne as a direct cost by the grant or counted as a direct cost towards a cost-sharing or matching requirement.

(c) *Replacement equipment.* The Federal share of replacement equipment shall be calculated as follows:

(1) *Step 1.* Determine the Federal share (percentage) of the equipment replaced.

(2) *Step 2.* Determine the percentage of the replacement equipment's cost that was covered by the amount received for trade-in or the sales proceeds from the equipment replaced.

(3) *Step 3.* Multiply the step 1 percent by the step 2 percentage.

(4) *Step 4.* If an additional outlay for the replacement equipment was charged as a direct cost either to HEW grant funds or to required cost-sharing or matching funds, calculate the Federal share attributable to that additional outlay as explained in paragraph (b)(2) of this section. Add that additional percentage to the step 3 percentage.

(d) *Institutional cost-sharing agreements.* If a grant is subject to an institutional cost-sharing agreement (see § 74.130(e)), the Federal share of property acquired under the grant shall be calculated as though there were no cost-sharing requirement applicable to the grant (that is, as if all the grantee's cost sharing were voluntary).

§ 74.143 Subgrantee's share of market value or sales proceeds.

Where this subpart requires a sharing of the market value or sales proceeds of property acquired under a subgrant, the non-Federal share shall be proportionally divided between the grantee and the subgrantee. The subgrantee shall be entitled to the amount it would have received or retained if the award to it had been made directly by the Federal Government. The remainder of the non-Federal share shall belong to the grantee.

INTANGIBLE PERSONAL PROPERTY

§ 74.144 Inventions and patents.

HHS's regulations on inventions and patents arising out of activities assisted by a grant are set forth in parts 6 and 8 of this title.

§ 74.145 Copyrights.

(a) *Works under grants.* Unless otherwise provided by the terms of the grant, when copyrightable material is developed in the course of or under a grant, the grantee is free to copyright the material or permit others to do so.

(b) *Works under subgrants.* Unless otherwise provided by the terms of the grant or subgrant, when copyrightable material is developed in the course of or under a subgrant, the subgrantee is free to copyright the material or permit others to do so.

(c) *HHS rights.* If any copyrightable material is developed in the course of or under a HHS grant or subgrant, HHS shall have a royalty-free, nonexclusive, and irrevocable right to reproduce, publish, or otherwise use, and to authorize others to use, the work for Federal Government purposes. A grantee awarding a subgrant may reserve a similar right for itself with respect to copyrightable material developed under that subgrant.

(d) *Exemption of student-developed works.* HHS awards training grants and other kinds of grants under which individuals are provided stipends or other financial assistance for the primary purpose of aiding them to further their education or training. Except as provided by the terms of the grant, copyrightable material developed by an individual or group of individuals in the course of education or training pursued with such assistance shall not be subject to the HHS right described in paragraph (c) of this section, unless the development of the material also receives other forms of support under the same or another HHS grant (such as a research grant).

SUBPART P
Procurements by Grantees and Subgrantees

§ 74.160 What procurements are subject to this subpart?

(a) This subpart applies to recipient procurements of supplies, equipment, and services (including construction).

(b) This subpart applies if any part of the cost of the property or service being procured by a recipient is treated as a direct cost under a grant or subgrant and is either borne by grant funds or counted toward satisfying a cost-sharing or matching requirement of the Federal grant. However, for research grants subject to an institutional cost-sharing agreement (see § 74.50(b)), this subpart applies only if some part of the cost is borne by grant funds.

(c) This subpart does not apply to the acquisition of property or services by one government from another government or by one agency or instrumentality of a government from another agency or instrumentality of the same or another government.[1]

§ 74.161 What rules govern the procurements?

For procurements by governmental recipients, awarding parties and recipients shall comply with Attachment O, "Procurement Standards," of OMB Circular A–102. For procurements by nongovernmental recipients, awarding parties and recipients shall comply with Attachment O, "Procurement Standards," of OMB Circular A–110. The versions of the attachments that apply are those in effect on October 1, 1979. The texts of those versions are in Appendices G and H of this part.

§ 74.162 Must request for OMB authorizations go through HHS' Office of Grants and Procurement (OGP)?

Requests for the Office of Federal Procurement Policy approval or authorizations referred to in paragraphs 1.b, 1.c, and 14.j of the OMB Circular A–102 attachment must be submitted, through appropriate HHS granting agency channels, to OGP. If OGP concurs in the request, OGP sends it to the Office of Federal Procurement Policy of OMB.

§ 74.163 How do the rules apply to subgrants?

(a) The Attachments O of the OMB circulars apply to procurements under subgrants as well as grants, although written, for the most part, in terms of grants. Except as explained in paragraphs (b) and (c) of this section, in the case of a subgrant, text that applies to a Federal agency is to be construed as applying to the grantee awarding the subgrant and text that applies to a grantee is to be construed as applying to the recipient of the subgrant.

(b) In section 4 and paragraphs 14.d through 14.i of Attachment O of OMB Circular A–102 and in paragraphs 4.e through 4.j of Attachment O of OMB Circular A–110, the references to Federal agencies apply to Federal agencies even in the case of a subgrant.

(c) In paragraph 2.a of Attachment O of OMB Circular A–102, the reference to a Federal concern is to be construed, in the case of a subgrant, as referring to a concern of either the Federal Government or the grantee awarding the subgrant.

§ 74.164 What clarifications are needed for the rule on access to contractor records?

The Attachments O require recipients to include in specified kinds of contracts a provision for access to the contractor's records by the recipient and the Federal Government. The following applies to the provision:

(a) The provision must require the contractor to place the same provision in any subcontract which would have to have the provision were it awarded directly by the recipient.

(b) The provision must require retention of records for three years after final payment is made under the contract or subcontract and all pending matters are closed. The provision must also require that, if an audit, litigation, or other action involving the records is started before the end of the three-year period, the records must be retained until all issues arising out of the action are resolved or until the end of the three-year period, whichever is later.

(c) In contracts and subcontracts under a subgrant, the provision must require that access to the records be provided to the grantee as well as the subgrantee and the Federal Government.

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[1] Instrumentalities of a government include government institutions of higher education and government hospitals. However, those institutions and hospitals are not considered governmental organizations for the other purposes of this subpart. (See paragraph (c) of § 74.4, "Applicability of this part.")

SUBPART Q
Cost Principles

§ 74.170 Basic policy; scope of subpart.

Grant funds may be used only for allowable costs of the activities for which the grant was awarded. This subpart identifies the principles to be used in determining allowable costs. The principles apply to grant-support activities conducted by grantees as well as by subgrantees and cost-type contractors (and subcontractors) under grants.

§ 74.171 Governments.

(a) The principles to be used in determining the allowable costs of activities conducted by governments are contained in Federal Management Circular 74–4, including any amendments to the Circular published in the **Federal Register** by OMB. A copy of this Circular may be obtained from the Division of Cost Allocation in any HHS Regional Office.

(b) Unless otherwise prescribed by OMB, future amendments to the Circular shall apply as of the start of a government's first fiscal year beginning after the amendment is published in the **Federal Register.**

§ 74.172 Institutions of higher education.

(a) The principles to be used in determining the allowable costs of activities conducted by institutions of higher education (other than for profit institutions) are contained in OMB Circular No. A–21, including any amendments to the Circular published in the **Federal Register** by OMB. A copy of this Circular may be obtained from the Division of Cost Allocation in any HHS Regional Office.

(b) Unless otherwise prescribed by OMB, future amendments to the Circular shall apply as of the start of an institution's first fiscal year beginning after the amendment is published in the **Federal Register.**

§ 74.173 Hospitals.

(a) *Research and development.* The principles for determining the allowable costs of research and development work performed by hospitals are in Appendix E to this part.

(b) *Other activities.* Appendix E to this part shall be used as a guide for determining the allowable costs of other activities conducted by hospitals.

§ 74.174 Other nonprofit organizations

(a) Except as provided in paragraph (c) of this section, the principles to be used in determining allowable costs of activities conducted by nonprofit organizations (other than governments, institutions of higher education, and hospitals) are contained in OMB Circular A-122, including any amendments to the Circular published in the **Federal Register** by OMB. A copy of this Circular may be obtained from the Division of Cost Allocation in any HHS Regional Office. Unless otherwise prescribed by OMB, amendments to the Circular shall apply as of the start of an organization's first fiscal year beginning after the amendment is published in the **Federal Register.**

(b) OMB Circular A-122 does not cover the treatment of bid and proposal costs or independent research and development costs. The following rules apply to these costs for nonprofit organizations subject to the Circular:

(1) *Bid and proposal costs.* Bid and proposal costs are the immediate costs of preparing bids, proposals, and applications for potential Federal and non-Federal grants, contracts, and agreements, including the development of scientific, cost, and other data needed to support the bids, proposals and applications. Bid and proposal costs of the current accounting period are allowable as indirect costs. Bid and proposal costs of past accounting periods are unallowable in the current period. However, if the organization's established practice is to treat these costs by some other method, they may be accepted if they are found to be reasonable and equitable. Bid and proposal costs do not include independent research and development costs covered by subparagraph (2) of this paragraph, or preaward costs covered by Attachment B, Paragraph 33, of OMB Circular A-122.

(2) *Independent research and development costs.* Independent research and development is research and development conducted by an organization which is not sponsored by Federal or non-Federal grants, contracts, or other agreements. Independent research and development shall be allocated its proportionate share of indirect costs on the same basis as the allocation of indirect costs to sponsored research and development. The costs of independent research and development, including its proportionate share of indirect costs, are unallowable.

(c) The principles to be used in determining allowable costs of activities conducted by the nonprofit organizations listed in Attachment C to OMB Circular A-122 are contained in Subpart 1-15.2 of the Federal Procurement Regulations (41 CFR 1-15.2), except that the costs of independent research and development, including its proportionate share of indirect costs, are unallowable.

§ 74.175 Subgrants and cost-type contracts.

(a) The cost principles applicable to a subgrantee or cost-type contractor under an HHS grant will not necessarily be the same as those applicable to the grantee. For example, where a State government awards a subgrant or cost-type contract to an institution of higher education, OMB Circular No. A–21 would apply to the costs incurred by the institution of higher

education, even though Federal Management Circular 74-4 would apply to the costs incurred by the State.

(b) The principles to be used in determining the allowable costs of work performed by for-profit organizations (other than hospitals) under cost-type contracts awarded to them under HHS grants are in 41 CFR Subpart 1-15.2.

§ 74.176 Costs allowable with approval.

Each set of cost principles identifies certain costs that, in order to be allowable, must be approved by the granting agency. Other costs do not require approval. The following procedures govern approval of these costs.

(a) When costs are treated as indirect costs (or are allocated pursuant to a government-wide cost allocation plan), acceptance of the costs as part of the indirect cost rate or cost allocation plan shall constitute approval.

(b)(1) When the costs are treated as direct costs, they must be approved in advance by the awarding party.

(2) If the costs are specified in the budget, approval of the budget shall constitute approval of the costs.

(3) If the costs are not specified in the budget, or there is no approved budget, the recipient shall obtain specific prior approval in writing from the awarding party. For this purpose the prior approval procedures of § 74.102 shall be followed, except that for formula or mandatory grants, the granting agency's written approval may be signed by any authorized official of the granting agency.

(c) The awarding party may waive or conditionally waive the requirement for its approval of the costs. Such a waiver shall apply only to the requirement for approval. If, upon audit or otherwise, it is determined that the costs do not meet other requirements or tests for allowability specified by the applicable cost principles, such as reasonableness and necessity, the costs may be disallowed.

(d) In the case of subgrants and cost-type contracts, no approval shall be given which is inconsistent with the purpose or the terms of the Federal grant.

Appendix A — [Reserved]
Appendix B — [Reserved]
Appendix C — [Reserved]
Appendix D — [Reserved]

APPENDIX E—PRINCIPLES FOR DETERMINING COSTS APPLICABLE TO RESEARCH AND DEVELOPMENT UNDER GRANTS AND CONTRACTS WITH HOSPITALS

(Appendix E is not included in this reprint of Part 74. A copy of Appendix E may be obtained from the Division of Cost Allocation in any Regional Office of The Department.)

Appendix F — [Reserved]

Appendix G—Attachment O, "Procurement Standards," of OMB Circular A-102, "Uniform Administrative Requirements for Grants-in-Aid to State and Local Governments"

1. *Applicability.*

a. This Attachment establishes standards and guidelines for the procurement of supplies, equipment, construction, and services for Federal assistance programs. These standards are furnished to ensure that such materials and services are obtained efficiently and economically and in compliance with the provisions of applicable Federal law and Executive orders.

b. No additional procurement requirements or subordinate regulations shall be imposed upon grantees by Executive agencies unless specifically required by Federal law or Executive orders or authorized by the Administrator for Federal Procurement Policy. This prohibition is not applicable to payment conditions issued in accordance with Treasury Circular 1075, individual grantee requirements pursuant to section 10 of the basic circular [1] or the provisions of this or other OMB circulars

c. Provisions of current subordinate requirements not conforming to this attachment shall be rescinded by grantor agencies unless approved by the Office of Federal Procurement Policy (OFPP).

2. *Grantee/Grantor Responsibility.*

a. These standards do not relieve the grantee of any contractual responsibilities under its contracts. The grantee is responsible, in accordance with good administrative practice and sound business judgment, for the settlement of all contractual and administrative issues arising out of procurements entered into in support of a grant. These include but are not limited to: source evaluation, protests, disputes, and claims. Executive agencies shall not substitute their judgment for that of the grantee unless the matter is primarily a Federal concern. Violations of law are to be referred to the local, State, or Federal authority having proper jurisdiction.

b. Grantees shall use their own procurement procedures which reflect applicable State and local laws and regulations, provided that procurements for Federal Assistance Programs conform to the standards set forth in this attachment and applicable Federal law.

3. *Grantee Procurement Improvement.*

Executive agencies awarding Federal grants or other assistance which require or allow for procurement by the recipients are encouraged to assist recipients in improving their procurement capabilities by providing them with technical assistance, training, publications, and other aid.

4. *Procurement System Reviews.*

a. Executive agencies are encouraged to perform reviews of their grantees' procurement systems if a continuing relationship with the grantee is anticipated or a substantial amount of the Federal assistance is to be used for procurement and review of individual contracts is anticipated. The purpose of the review shall be to determine: (1) whether a grantee's procurement system meets the standards prescribed by this Attachment or other criteria acceptable to the OFPP, such as provisions of the model procurement code for State and local government and (2) whether the grantee's procurement system should be certified by the reviewing agency. Such a review will also give an agency an opportunity to give technical assistance to a grantee to remedy its procurement system if it does not fully comply. In addition, such a review may provide a basis for deciding whether the grantee's contracts and related procurement documents should be subject to the grantor's prior approval, as provided by Section 6.

b. In conducting procurement system reviews, grantor agencies will evaluate a grantee's procurement system in terms of whether it complies with the standards prescribed by this Attachment and represents a fair, efficient and effective procurement system. To the maximum extent feasible, reviewers will rely upon State or local evaluations and analyses performed by agencies or organizations independent of the grantee contracting activity.

c. When a Federal grantor agency completes a procurement review, it shall furnish a report to the grantee, with a copy to OFPP.

d. All agencies should normally rely upon the resultant findings or certification for a period of 24 months before another review is performed.

e. Reviews shall be conducted in accordance with standards and guidelines approved or issued by OFPP.

f. The reviews authorized by Section 6 are waived if a grantee's procurement system is certified.

5. *Protest Procedures.*

Grantor agencies may develop an administrative procedure to handle complaints or protests regarding

[1] For HHS grants and subgrants, the requirements referred to are those issued under 45 CFR 74.7, "Special grant or subgrant conditions."

grantee contractor selection actions. The procedure shall be limited as follows:

a. No protest shall be accepted by the grantor agency until all administrative remedies at the grantee level have been exhausted.

b. Review is limited to:

(i) Violations of Federal law or regulations. Violations of State or local law shall be under the jurisdiction of State or local authorities.

(ii) Violations of grantee's protest procedures or failure to review a complaint or protest.

6. *Grantor Review of Proposed Contracts.*

Federal grantor pre-award review and approval of the grantee's proposed contracts and related procurement documents, such as requests for proposals and invitations for bids, is permitted only under the following circumstances:

a. The procurement is expected to exceed $10,000 and is to be awarded without competition or only one bid or offer is received in response to solicitation.

b. The procurement expected to exceed $10,000 specifies a "brand name" product; or

c. The grantee's procurement procedures or operation fails to comply with one or more significant aspects of this Attachment. The grantor agency shall notify the grantee in writing, with a copy of such notification to the OFPP.

7. *Code of Conduct.*

Grantees shall maintain a written code or standards of conduct which shall govern the performance of their officers, employees or agents engaged in the award and administration of contracts supported by Federal funds. No employee, officer or agent of the grantee shall participate in selection, or in the award or administration of a contract supported by Federal funds if a conflict of interest, real or apparent, would be involved. Such a conflict would arise when:

a. the employee, officer or agent;

b. any member of his immediate family;

c. his or her partner; or

d. an organization which employs, or is about to employ, any of the above, has a financial or other interest in the firm selected for award.

The grantee's officers, employees or agents shall neither solicit nor accept gratuities, favors or anything of monetary value from contractors, potential contractors, or parties to subagreements.

Grantees may set minimum rules where the financial interest is not substantial or the gift is an unsolicited item of nominal intrinsic value.

To the extent permitted by State or local law or regulations, such standards of conduct shall provide for penalties, sanctions, or other disciplinary actions for violations of such standards by the grantee's officers, employees, or agents, or by contractors or their agents.

8. *Procurement Procedures.*

The grantee shall establish procurement procedures which provide that proposed procurement action shall be reviewed by grantee officials to avoid the purchase of unnecessary or duplicative items. Consideration should be given to consolidation or breaking out to obtain a more economical purchase. Where appropriate, an analysis shall be made of lease versus purchase alternatives, and any other appropriate analysis to determine which approach would be the most economical. To foster greater economy and efficiency grantees are encouraged to enter into State and local intergovernmental agreements for procurement or use of common goods and services.

9. *Contracting With Small and Minority Firms, Women's Business Enterprise and Labor Surplus Area Firms.*

a. It is national policy to award a fair share of contracts to small and minority business firms. Accordingly, affirmative steps must be taken to assure that small and minority businesses are utilized when possible as sources of supplies, equipment, construction and services. Affirmative steps shall include the following:

(1) Including qualified small and minority businesses on solicitation lists.

(2) Assuring that small and minority businesses are solicited whenever they are potential sources.

(3) When economically feasible, dividing total requirements into smaller tasks or quantities so as to permit maximum small and minority business participation.

(4) Where the requirement permits, establishing delivery schedules which will encourage participation by small and minority business.

(5) Using the services and assistance of the Small Business Administration, the Office of Minority Business Enterprise of the Department of Commerce and the Community Services Administration as required.[2]

(6) If any subcontracts are to be let, requiring the prime contractor to take the affirmative steps in 1 through 5 above.

b. Grantees shall take similar appropriate affirmative action in support of women's business enterprises.

c. Grantees are encouraged to procure goods and services from labor surplus areas.

d. Grantor agencies may impose additional regulations and requirements in the foregoing areas only to

[2] Additional advice and assistance regarding the use of small or minority businesses may be obtained from the following HHS components:

1. The Office of Facilities Engineering and its regional offices (for assistance in identifying minority-owned firms interested in performing construction, alteration, or renovation work).

2. The Office of Grants and Procurement.

the extent specifically mandated by statute or presidential direction.

10. *Selection Procedures.*

a. All procurement transactions, regardless of whether by sealed bids or by negotiation and without regard to dollar value, shall be conducted in a manner that provides maximum open and free competition consistent with this attachment. Procurement procedures shall not restrict or eliminate competition. Examples of what is considered to be restrictive of competition include, but are not limited to: (1) placing unreasonable requirements on firms in order for them to qualify to do business, (2) noncompetitive practices between firms, (3) organizational conflicts of interest, and (4) unnecessary experience and bonding requirements.

b. The grantee shall have written selection procedures which shall provide, as a minimum, the following procedural requirements:

(1) Solicitations of offers, whether by competitive sealed bids or competitive negotiation, shall:

(a) incorporate a clear and accurate description of the technical requirements for the material, product, or service to be procured. Such description shall not, in competitive procurements, contain features which unduly restrict competition. The description may include a statement of the qualitative nature of the material, product or service to be procured, and when necessary, shall set forth those minimum essential characteristics and standards to which it must conform if it is to satisfy its intended use. Detailed product specifications should be avoided if at all possible. When it is impractical or uneconomical to make a clear and accurate description of the technical requirements, a "brand name or equal" description may be used as a means to define the performance or other salient requirements of a procurement. The specific features of the named brand which must be met by offerors shall be clearly stated.

(b) clearly set forth all requirements which offerors must fulfill and all other factors to be used in evaluating bids or proposals.

(2) Awards shall be made only to responsible contractors that possess the potential ability to perform successfully under the terms and conditions of a proposed procurement. Consideration shall be given to such matters as contractor integrity, compliance with public policy, record of past performance, and financial and technical resources.

11. *Method of Procurement.*

Procurement under grants shall be made by one of the following methods, as described herein: (a) small purchase procedures; (b) competitive sealed bids (formal advertising); (c) competitive negotiation; (d) noncompetitive negotiation.

a. Small purchase procedures are those relatively simple and informal procurement methods that are sound and appropriate for a procurement of services, supplies or other property, costing in the aggregate not more than $10,000. Grantees shall comply with State or local small purchase dollar limits under $10,000. If small purchase procedures are used for a procurement under a grant, price or rate quotations shall be obtained from an adequate number of qualified sources.

b. In competitive sealed bids (formal advertising), sealed bids are publicly solicited and a firm-fixed-price contract (lump sum or unit price) is awarded to the responsible bidder whose bid, conforming with all the material terms and conditions of the invitation for bids, is lowest in price.

(1) In order for formal advertising to be feasible, appropriate conditions must be present, including, as a minimum, the following:

(a) A complete, adequate and realistic specification or purchase description is available.

(b) Two or more responsible suppliers are willing and able to compete effectively for the grantee's business.

(c) The procurement lends itself to a firm-fixed-price contract, and selection of the successful bidder can appropriately be made principally on the basis of price.

(2) If formal advertising is used for a procurement under a grant, the following requirements shall apply:

(a) A sufficient time prior to the date set for opening of bids, bids shall be solicited from an adequate number of known suppliers. In addition, the invitation shall be publicly advertised.

(b) The invitation for bids, including specifications and pertinent attachments, shall clearly define the items or services needed in order for the bidders to properly respond to the invitation.

(c) All bids shall be opened publicly at the time and place stated in the invitation for bids.

(d) A firm-fixed-price contract award shall be made by written notice to that responsible bidder whose bid, conforming to the invitation for bids, is lowest. Where specified in the bidding documents, factors such as discounts, transportation costs and life cycle costs shall be considered in determining which bid is lowest. Payment discounts may only be used to determine low bid when prior experience of the Grantee indicates that such discounts are generally taken.

(e) Any or all bids may be rejected when there are sound documented business reasons in the best interest of the program.

c. In competitive negotiation, proposals are requested from a number of sources and the Request for Proposal is publicized, negotiations are normally conducted with more than one of the sources submitting offers, and

either a fixed-price or cost-reimbursable type contract is awarded, as appropriate. Competitive negotiation may be used if conditions are not appropriate for the use of formal advertising. If competitive negotiation is used for a procurement under a grant, the following requirements shall apply:

(1) Proposals shall be solicited from an adequate number of qualified sources to permit reasonable competition consistent with the nature and requirements of the procurement. The Request for Proposals shall be publicized and reasonable requests by other sources to compete shall be honored to the maximum extent practicable.

(2) The request for proposal shall identify all significant evaluation factors, including price or cost where required and their relative importance.

(3) The grantee shall provide mechanisms for technical evaluation of the proposals received, determinations of responsible offerors for the purpose of written or oral discussions, and selection for contract award.

(4) Award may be made to the responsible offeror whose proposal will be most advantageous to the procuring party, price and other factors considered. Unsuccessful offerors should be notified promptly.

(5) Grantees may utilize competitive negotiation procedures for procurement of Architectural/Engineering professional services, whereby competitors' qualifications are evaluated and the most qualified competitor is selected, subject to negotiation of fair and reasonable compensation.

d. Noncompetitive negotiation is procurement through solicitation of a proposal from only one source, or after solicitation of a number of sources, competition is determined inadequate. Noncompetitive negotiation may be used when the award of a contract is infeasible under small purchase, competitive bidding (formal advertising) or competitive negotiation procedures. Circumstances under which a contract may be awarded by noncompetitive negotiation are limited to the following:

(1) the item is available only from a single source;

(2) public exigency or emergency when the urgency for the requirement will not permit a delay incident to competitive solicitation;

(3) the Federal grantor agency authorizes noncompetitive negotiations; or

(4) after solicitation of a number of sources, competition is determined inadequate.

e. Additional innovative procurement methods may be used by Grantees with the approval of the Grantor Agency. A copy of such approval shall be sent to OFPP.

12. *Contract Pricing.*

The cost plus a percentage of cost and percentage of construction cost method of contracting shall not be used. Grantees shall perform some form of cost or price analysis in connection with every procurement action including contract modifications. Costs or prices based on estimated costs for contracts under grants shall be allowed only to the extent that costs incurred or cost estimates included in negotiated prices are consistent with Federal cost principles.

13. *Grantee Procurement Records.*

Grantees shall maintain records sufficient to detail the significant history of a procurement. These records shall include, but are not necessarily limited to, information pertinent to the following: rationale for the method of procurement, selection of contract type, contractor selection or rejection, and the basis for the cost or price.

14. *Contract Provisions.*

In addition to provisions defining a sound and complete procurement contract, any recipient of Federal grant funds shall include the following contract provisions or conditions in all procurement contracts and subcontracts as required by the provision, Federal Law or the Grantor Agency.

a. Contracts other than small purchases shall contain provisions or conditions which will allow for administrative, contractual, or legal remedies in instances where contractors violate or breach contract terms, and provide for such sanctions and penalties as may be appropriate.

b. All contracts in excess of $10,000 shall contain suitable provisions for termination by the grantee including the manner by which it will be effected and the basis for settlement. In addition, such contracts shall describe conditions under which the contract may be terminated for default as well as conditions where the contract may be terminated because of circumstances beyond the control of the contractor.

c. All contracts awarded in excess of $10,000 by grantees and their contractors or subgrantees shall contain a provision requiring compliance with Executive Order 11246, entitled "Equal Employment Opportunity," as amended by Executive Order 11375, and as supplemented in Department of Labor regulations (41 CFR Part 60).

d. All contracts and subgrants for *construction* or repair shall include a provision for compliance with the Copeland "Anti-Kickback" Act (18 USC 874) as supplemented in Department of Labor regulations (29 CFR, Part 3). This Act provides that each contractor or subgrantee shall be prohibited from inducing, by any means, any person employed in the construction, completion, or repair of public work, to give up any part of the compensation to which he is otherwise entitled. The grantee shall report all suspected or reported violations to the grantor agency.

e. When required by the Federal grant program legislation, all *construction* contracts in excess of $2,000 awarded by grantees and subgrantees shall include a

provision for compliance with the Davis-Bacon Act (40 USC 276a to a-7) as supplemented by Department of Labor regulations (29 CFR Part 5). Under this Act contractors shall be required to pay wages to laborers and mechanics at a rate not less than the minimum wages specified in a wage determination made by the Secretary of Labor. In addition, contractors shall be required to pay wages not less often than once a week. The grantee shall place a copy of the current prevailing wage determination issued by the Department of Labor in each solicitation and the award of a contract shall be conditioned upon the acceptance of the wage determination. The grantee shall report all suspected or reported violations to the grantor agency.

f. Where applicable, all contracts awarded by grantees and subgrantees in excess of $2,000 for *construction* contracts and in excess of $2,500 for other contracts which involve the employment of mechanics or laborers shall include a provision for compliance with sections 103 and 107 of the Contract Work Hours and Safety Standards Act (40 USC 327-330) as supplemented by Department of Labor regulations (29 CFR, Part 5). Under section 103 of the Act, each contractor shall be required to compute the wages of every mechanic and laborer on the basis of a standard work day of 8 hours and a standard work week of 40 hours. Work in excess of the standard workday or workweek is permissible provided that the worker is compensated at a rate of not less than 1½ times the basic rate of pay for all hours worked in excess of 8 hours in any calendar day or 40 hours in the work week. Section 107 of the Act is applicable to construction work and provides that no laborer or mechanic shall be required to work in surroundings or under working conditions which are unsanitary, hazardous, or dangerous to his health and safety as determined under construction, safety and health standards promulgated by the Secretary of Labor. These requirements do not apply to the purchases of supplies or materials or articles ordinarily available on the open market, or contracts for transportation or transmission of intelligence.

g. The contract shall include notice of grantor agency requirements and regulations pertaining to reporting and patent rights under any contract involving research, developmental, experimental or demonstration work with respect to any discovery or invention which arises or is developed in the course of or under such contract, and of grantor agency requirements and regulations pertaining to copyrights and rights in data.[5]

h. All negotiated contracts (except those awarded by small purchases procedures) awarded by grantees shall include a provision to the effect that the grantee, the Federal grantor agency, the Comptroller General of the United States, or any of their duly authorized representatives, shall have access to any books, documents, papers, and records of the contractor which are directly pertinent to that specific contract, for the purpose of making audit, examination, excerpts, and transcriptions.

Grantees shall require contractors to maintain all required records for three years after grantees make final payments and all other pending matters are closed.[6]

i. Contracts, subcontracts, and subgrants of amounts in excess of $100,000 shall contain a provision which requires compliance with all applicable standards, orders, or requirements issued under Section 306 of the Clean Air Act (42 U.S.C. 1857(h)), Section 508 of the Clean Water Act (33 U.S.C. 1368), Executive Order 11738, and Environmental Protection Agency regulations (40 CFR Part 15), which prohibit the use under non-exempt Federal contracts, grants or loans of facilities included on the EPA List of Violating Facilities. The provision shall require reporting of violations to the grantor agency and to the U.S.E.P.A. Assistant Administrator for Enforcement (EN-329).

j. Contracts shall recognize mandatory standards and policies relating to energy efficiency which are contained in the State energy conservation plan issued in compliance with the Energy Policy and Conservation Act (Pub. L. 94-165).

Grantor Agencies are permitted to require changes, remedies, changed conditions, access and record retention and suspension of work clauses approved by the Office of Federal Procurement Policy.

15. *Contract Administration.*

Grantees shall maintain a contract administration system insuring that contractors perform in accordance with the terms, conditions, and specifications of their contracts or purchase orders.

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[5] HHS Department-wide provisions on inventions and patents arising out of activities assisted by a grant are in 45 CFR Parts 6 and 8. Department-wide provisions on copyrights under grants and subgrants are in 45 CFR Part 74, Subpart O. Other provisions on these topics or on rights to data may be in other terms of a grant. If any contract may give rise to works, inventions, patents, or data subject to any of these provisions, the recipient shall place a requirement in the contract for contractor and subcontractor compliance with the provisions. The recipient need not place requirements of this kind in all contracts.

[6] For clarification of paragraph 14.h as it applies to HHS grants and subgrants, see 45 CFR 74.164.

Appendix H—Attachment O, "Procurement Standards," of OMB Circular A-110, "Grants and Agreements with Institutions of Higher Education, Hospitals, and Other Nonprofit Organizations"

1. This attachment provides standards for use by recipients in establishing procedures for the procurement of supplies, equipment, construction and other services with Federal funds.[1] These standards are furnished to ensure that such materials and services are obtained in an effective manner and in compliance with the provisions of applicable Federal law and executive orders. No additional procurement standards or requirements shall be imposed by the Federal sponsoring agencies upon recipients unless specifically required by Federal statute or executive orders.

2. The standards contained in this attachment do not relieve the recipient of the contractual responsibilities arising under its contracts. The recipient is the responsible authority, without recourse to the Federal sponsoring agency regarding the settlement and satisfaction of all contractual and administrative issues arising out of procurements entered into, in support of a grant or other agreement. This includes disputes, claims, protests of award, source evaluation or other matters of a contractual nature. Matters concerning violation of law are to be referred to such local, State or Federal authority as may have proper jurisdiction.

3. Recipients may use their own procurement policies and procedures. However, all recipients shall adhere to the standards set forth in paragraphs 3 and 4.

a. The recipient shall maintain a code or standards of conduct that shall govern the performance of its officers, employees or agents engaged in the awarding and administration of contracts using Federal funds. No employee, officer or agent shall participate in the selection, award or administration of a contract in which Federal funds are used, where, to his knowledge, he or his immediate family, partners, or organization in which he or his immediate family or partner has a financial interest or with whom he is negotiating or has any arrangement concerning prospective employment. The recipients' officers, employees or agents shall neither solicit nor accept gratuities, favors or anything of monetary value from contractors or potential contractors. Such standards shall provide for disciplinary actions to be applied for violations of such standards by the recipients' officers, employees or agents.

b. All procurement transactions shall be conducted in a manner to provide, to the maximum extent practical, open and free competition. The recipient should be alert to organizational conflicts of interest or noncompetitive practices among contractors that may restrict or eliminate competition or otherwise restrain trade. In order to ensure objective contractor performance and eliminate unfair competitive advantage, contractors that develop or draft specifications, requirements, statements of work, invitations for bids and/or requests for proposals should be excluded from competing for such procurements.[2] Awards shall be made to the bidder/offeror whose bid/offer is responsive to the solicitation and is most advantageous to the recipient, price and other factors considered. Socicitations shall clearly set forth all requirements that the bidder/offeror must fulfill in order for his bid/offer to be evaluated by the recipient. Any and all bids/offers may be rejected when it is in the recipient's interest to do so.

c. All recipients shall establish procurement procedures that provide for, at a minimum, the following procedural requirements.

(1) Proposed procurement actions shall follow a procedure to assure the avoidance of purchasing unnecessary or duplicative items. Where appropriate, an analysis shall be made of lease and purchase, alternatives to determine which would be the most economical, practical procurement.

(2) Solicitations for goods and services shall be based upon a clear and accurate description of the technical requirements for the material, product or service to be procured. Such a description shall not, in competitive procurements, contain features which unduly restrict competition. "Brand name or equal" descriptions may be used as a means to define the performance or other salient requirements of a procurement, and when so used the specific features of the named brand which must be met by bidders/offerors shall be clearly specified.

(3) Positive efforts shall be made by the recipients to utilize small business and minority-owned business sources of supplies and services. Such efforts should

[1] For the applicability of this attachment under HHS grants and subgrants, see 45 CFR 74.160 and 74.161.

[2] HHS granting agencies have been authorized by OMB to waive this requirement for a particular procurement upon request of the recipient making the procurement.

allow these sources the maximum feasible opportunity to compete for contracts utilizing Federal funds.[3]

(4) The type of procuring instruments used, e.g., fixed price contracts, cost reimbursable contracts, purchase orders, incentive contracts, shall be determined by the recipient but must be appropriate for the particular procurement and for promoting the best interest of the program involved. The "cost-plus-a-percentage-of-cost" method of contracting shall not be used.

(5) Contracts shall be made only with responsible contractors who possess the potential ability to perform successfully under the terms and conditions of a proposed procurement. Consideration shall be given to such matters as contractor integrity, record of past performance, financial and technical resources or accessibility to other necessary resources.

(6) All proposed sole source contracts or where only one bid or proposal is received in which the aggregate expenditure is expected to exceed $5,000 shall be subject to prior approval at the discretion of the Federal sponsoring agency.

(7) Some form of price or cost analysis should be made in connection with every procurement action. Price analysis may be accomplished in various ways, including the comparison of price quotations submitted, market prices and similar indicia, together with discounts. Cost analysis is the review and evaluation of each element of cost to determine reasonableness, allocability and allowability.

(8) Procurement records and files for purchases in excess of $10,000 shall include the following:

(a) Basis for contractors selection;

(b) Justification for lack of competition when competitive bids or offers are not obtained;

(c) Basis for award cost or price.

(9) A system for contract administration shall be maintained to ensure contractor conformance with terms, conditions and specifications of the contract, and to ensure adequate and timely followup of all purchases.

4. The recipient shall include, in addition to provisions to define a sound and complete agreement, the following provisions in all contracts. These provisions shall also be applied to subcontracts.

a. Contracts in excess of $10,000 shall contain contractual provisions or conditions that will allow for administrative, contractual or legal remedies in instances in which contractors violate or breach contract terms, and provide for such remedial actions as may be appropriate.

b. All contracts in excess of $10,000 shall contain suitable provisions for termination by the recipient including the manner by which termination will be effected and the basis for settlement. In addition, such contracts shall describe conditions under which the contract may be terminated for default as well as conditions where the contract may be terminated because of circumstances beyond the control of the contractor.

c. In all contracts for construction or facility improvement awarded for more than $100,000, recipients shall observe the bonding requirements provided in Attachment B to this circular.[4]

d. All contracts awarded by recipients and their contractors or subgrantees having a value of more than $10,000, shall contain a provision requiring compliance with Executive Order 11246, entitled "Equal Employment Opportunity," as amended by Executive Order 11375, and as supplemented in Department of Labor regulations (41 CFR, Part 60).

e. All contracts and subgrants in excess of $2,000 for construction or repair awarded by recipients and subrecipients shall include a provision for compliance with the Copeland "Anti-Kick Back" Act (18 U.S.C. 874) as supplemented in Department of Labor regulations (29 CFR, Part 3). This Act provides that each contractor or subgrantee shall be prohibited from inducing, by any means, any person employed in the construction, completion, or repair of public work, to give up any part of the compensation to which he is otherwise entitled. The recipient shall report all suspected or reported violations to the Federal sponsoring agency.

f. When required by the Federal program legislation, all construction contracts awarded by the recipients and subrecipients of more than $2,000 shall include a provision for compliance with the Davis-Bacon Act (40 U.S.C. 276a to a-7) and as supplemented by Department of Labor regulations (29 CFR, Part 5). Under this Act contractors shall be required to pay wages to laborers and mechanics at a rate not less than the minimum wages specified in a wage determination made by the Secretary of Labor. In addition, contractors shall be required to pay wages not less than once a week. The recipient shall place a copy of the current

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[3] Advice and assistance regarding the use of small or minority businesses may be obtained from the following organizations:

1. The Small Business Administration and its field offices.
2. The Office of Minority Business Enterprise, Department of Commerce.
3. The Community Services Administration.
4. The Office of Facilities Engineering, HHS, and its regional offices (for assistance in identifying minority-owned firms interested in performing construction, alteration, or renovation work).
5. The Office of Grants and Procurement, HHS.

[4] For HHS grants and subgrants, the requirements referred to are those in 45 CFR 74.16.

prevailing wage determination issued by the Department of Labor in each solicitation and the award of a contract shall be conditioned upon the acceptance of the wage determination. The recipient shall report all suspected or reported violations to the Federal sponsoring agency.

g. When applicable, all contracts awarded by recipients in excess of $2,000 for construction contracts and in excess of $2,500 for other contracts that involve the employment of mechanics or laborers, shall include a provision for compliance with sections 103 and 107 of the Contract Work Hours and Safety Standards Act (40 U.S.C. 327–330) as supplemented by Department of Labor regulations (29 CFR, Part 5). Under section 103 of the Act, each contractor shall be required to compute the wages of every mechanic and laborer on the basis of a standard work day of 8 hours and a standard work week of 40 hours. Work in excess of the standard workday or workweek is permissible provided that the worker is compensated at a rate of not less than 1½ times the basic rate of pay for all hours worked in excess of 8 hours in any calendar day or 40 hours in the workweek. Section 107 of the Act is applicable to construction work and provides that no laborer or mechanic shall be required to work in surroundings or under working conditions which are unsanitary, hazardous or dangerous to his health and safety as determined under construction safety and health standards promulgated by the Secretary of Labor. These requirements do not apply to the purchases of supplies or materials or articles ordinarily available on the open market, or contracts for transportation or transmission of intelligence.

h. Contracts or agreements, the principal purpose of which is to create, develop or improve products, processes or methods; or for exploration into fields that directly concern public health, safety or welfare; or contracts in the field of science or technology in which there has been little significant experience outside of work funded by Federal assistance, shall contain a notice to the effect that matters regarding rights to inventions and materials generated under the contract or agreement are subject to the regulations issued by the Federal sponsoring agency and the recipient. The contractor shall be advised as to the source of additional information regarding these matters.[5]

i. All negotiated contracts (except those of $10,000 or less) awarded by recipients shall include a provision to the effect that the recipient, the Federal sponsoring agency, the Comptroller General of the United States, or any of their duly authorized representatives, shall have access to any books, documents, papers and records of the contractor which are directly pertinent to a specific program for the purpose of making audits, examinations, excerpts and transcriptions.[6]

j. Contracts and subgrants of amounts in excess of $100,000 shall contain a provision that requires the recipient to agree to comply with all applicable standards, orders or regulations issued pursuant to the Clean Air Act of 1970 (42 U.S.C. 1857 et seq.) and the Federal Water Pollution Control Act (33 U.S.C. 1251 et seq.) as amended. Violations shall be reported to the Federal sponsoring agency and the Regional Office of the Environmental Protection Agency.

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[5] HHS Department-wide provisions on inventions arising out of activities assisted by a grant are in 45 CFR Parts 6 and 8. Department-wide provisions on copyrights arising under grants and subgrants are in 45 CFR Part 74, Subpart O. Other provisions on these topics and on rights to data may be in other terms of a grant. If any contract may give rise to works, inventions, patents or data subject to these provisions, the recipient shall place a requirement in the contract for contractor and subcontractor compliance with the provisions.

[6] For clarification of this requirement as it applies to HHS grants and subgrants, see 45 CFR 74.164.

OMB Circular A-110
Grants and Agreements with Institutions of Higher Education,
Hospitals and Other Nonprofit Organizations--Uniform Administrative Requirements

Attachment F
Standards for Financial Management Systems

1. This attachment prescribes standards for financial management systems of recipients. Federal sponsoring agencies shall not impose additional standards on recipients unless specifically provided for in the applicable statutes (e.g., the Joint Funding Simplification Act, P.L 93-510) or other attachments to this circular. However, Federal sponsoring agencies are encouraged to make suggestions and assist recipients in establishing or improving financing management systems when such assistance is needed or requested.

2. Recipients' financial management systems shall provide for:

a. Accurate, current, and complete disclosure of the financial results of each federally sponsored project or program in accordance with the reporting requirements set forth in Attachment G to this circular. When a Federal sponsoring agency requires reporting on an accrual basis, the recipient shall not be required to establish an accrual accounting system but shall develop such accrual data for its reports on the basis of an analysis of the documentation on hand.

b. Records that identify adequately the source and application of funds for federally sponsored activities. These records shall contain information pertaining to Federal awards, authorizations, obligations, unobligated balances, assets, outlays, and income.

c. Effective control over and accountability for all funds, property and other assets. Recipients shall adequately safeguard all such assets and shall assure that they are used solely for authorized purposes.

d. Comparison of actual outlays with budget amounts for each grant or other agreement. Whenever appropriate or required by the Federal sponsoring agency, financial information should be related to performance and unit cost data.

e. Procedures to minimize the time elapsing between the transfer of funds from the U.S. Treasury and the disbursement by the recipient, whenever funds are advanced by the Federal Government. When advances are made by a letter-of-credit method, the recipient shall make drawdowns as close as possible to the time of making disbursements.

f. Procedures for determining the reasonableness, allowability and allocability of costs in accordance with the provisions of the applicable Federal cost principles and the terms of the grant or other agreements.

g. Accounting records that are supported by source documentation.

Note: Paragraph 2.h contains the audit requirements referred to in 45 CFR 74.62(b).

h. Examinations in the form of audits or internal audits. Such audits shall be made by qualified individuals who are sufficiently independent of those who authorize the expenditure of Federal funds, to produce unbiased opinions, conclusions or judgments. They shall meet the independence criteria along the lines of Chapter 3, Part 3 of the U.S. General Accounting Office publication, Standards for Audit of Governmental Organizations, Programs, Activities and Functions. These examinations are intended to ascertain the effectiveness of the financial management systems and internal procedures that have been established to meet the terms and conditions of the agreements. It is not intended that each agreement awarded to the recipient be examined. Generally, examinations should be conducted on an organization-wide basis to test the fiscal integrity of financial transactions, as well as compliance with the terms and conditions of the Federal grants and other agreements. Such tests would include an appropriate sampling of Federal agreements. Examinations will be conducted with reasonable frequency, on a continuing basis or at scheduled intervals, usually annually, but not less frequently than every two years. The frequency of these examinations shall depend upon the nature, size and the complexity of the activity. These examinations do not relieve Federal agencies of their audit responsibilities, but may affect the frequency and scope of such audits.

i. A systematic method to assure timely and appropriate resolution of audit findings and recommendations.

3. Primary recipients shall require subrecipients (as defined in paragraph 5 of the basic circular) to adopt the standards in paragraph 2, above except for the requirement in subparagraph 2e, regarding the use of the letter-of-credit method and that part of subparagraph 2a, regarding reporting forms and frequencies prescribed in Attachment G to this circular.

Title 45—[Amended]

E. 45 CFR Part 74 is amended as follows:

1. The table of contents is amended as follows:

PART 74—ADMINISTRATION OF GRANTS

* * * * *

Subpart P—Procurements by Grantees and Subgrantees

* * * * *

Sec.

74.162 Must requests for OMB authorizations go through HHS's Office of Procurement, Assistance and Logistics (OPAL)?

* * * * *

Subpart Q—Cost Principles

* * * * *

74.175 For-profit organizations other than for-profit hospitals.

74.176 Subgrants and cost-type contracts.

74.177 Costs allowable with approval.

* * * * *

Subparts U–Z [Reserved]

Subpart AA—Special Provisions for Grants and Subgrants to For-Profit Organizations

74.701 Scope of subpart.

74.705 Prohibition against profit.

74.710 Real property, equipment, and supplies.

74.715 General program income.

74.720 Cost sharing under research grants.

* * * * *

2. Section 74.3 is amended to add the following definition after the definition of "Federally recognized Indian tribal government":

§ 74.3 Definitions.

* * * * *

"For-profit" organization or institution means a corporation or other legal entity which is organized or operated for the profit or benefit of its shareholders or other owners.

* * * * *

3. Section 74.3 is further amended to remove the definition of "OGP" and to add the following definition after the definition of "OMB":

* * * * *

"OPAL" means the Office of Procurement, Assistance and Logistics, which is an organizational component within the Office of the Secretary, HHS, and reports to the Assistant Secretary for Management and Budget.

* * * * *

4. Section 74.4 is amended to remove the words "for-profit organization" from paragraphs (a) and (b) and to add a new paragraph (d). As revised, § 74.4 reads as follows:

§ 74.4 Applicability of this part.

(a) *General.* Except where inconsistent with Federal statutes, regulations, or other terms of a grant, this part applies to all HHS grants, other than the block grant programs identified in 45 CFR 96.1. However, unless expressly made applicable by the granting agency, this part shall not apply when the grantee is a Federal agency, foreign government or organization, international organization such as the United Nations, or individual.

(b) *Subgrants.* for each substantive provision in this part, either the language of the provision itself or other text in the same subpart will indicate whether the provision affects only grants, only subgrants, or both. Use of the term "recipient" (as defined in § 74.3) in a provision shall be taken as referring equally to grantees and subgrantees. Similarly, use of the term "awarding party" (as defined in § 74.3) shall be taken as referring equally to granting agencies and to grantees awarding subgrants. However, unless expressly made applicable by the granting agency, this part need not be applied by the grantee to a subgrant if the subgrantee is a Federal agency, foreign government or organization, international organization such as the United Nations, or individual.

(c) *Public institutions of higher education and hospitals.* Grants and subgrants to institutions of higher education and hospitals operated by a government shall be subject only to provisions of this subpart that apply to nongovernmental organizations.

(d) *For-profit organizations.* The attention of for-profit organizations is directed to Subpart AA of this part. The special provisions in that subpart for grants and subgrants to those organizations contain exceptions to other portions of this part.

§ 74.6 [Amended]

5. Section 74.6 is amended to revise the abbreviation "OGP" in paragraphs (c)(2) and (d) to read "OPAL".

§ 74.12 [Amended]

6. Section 74.12 is amended to revise the abbreviation "OGP" in the second sentence to read "OPAL".

§ 74.72 [Amended]

7. Section 74.72 is amended to revise the abbreviation "OGP" in paragraphs (a) and (b) to read "OPAL".

8. Section 74.101 is revised to read as follows:

§ 74.101 Relationship to cost principles.

The cost principles prescribed by Subpart Q of this part contain requirements for prior approval of certain types of costs (see § 74.177). Except when waived, those requirements apply to all grants and subgrants even if §§ 74.103 through 74.106 do not.

9. Section 74.105 is amended by revising paragraph (c) to read as follows:

§ 74.105 Budget revisions—nonconstruction projects.

* * * * *

(c) Except as provided in §§ 74.107 and 74.177, other budget changes under nonconstruction grants do not require approval.

§ 74.121 [Amended]

10. Section 74.121 is amended to revise the abbreviation "OGP" in paragraphs (a) and (c) to read "OPAL".

11. Section 74.130 is amended to revise paragraph (d) to read as follows:

§ 74.130. Scope and applicability of this subpart.

* * * * *

(d) Equipment or supplies acquired by a contractor under its contract are not subject to this subpart if, by the terms of the contract, title to the property vests in the contractor or another third party.

* * * * *

12. Section 74.162 is revised to read as follows:

§ 74.162 Must requests for OMB authorizations go through HHS's Office of Procurement, Assistance and Logistics (OPAL)?

Requests for the Office of Federal Procurement Policy approval or authorizations referred to in paragraphs 1.b, 1.c, and 14.j of the OMB Circular A–102 attachment must be submitted, through appropriate HHS granting agency channels, to OPAL. If OPAL concurs in the request, OPAL sends it to the Office of Federal Procurement Policy of OMB.

§ 74.171 [Amended]

13. Section 74.171 is amended to revise the words "Federal Management Circular 74-4" in paragraph (a) to read "OMB Circular No. A–87".

14. Subpart Q is amended by adding a new § 74.175, by redesignating and revising the current § 74.175 as § 74.176 and by redesignating the current § 74.176 as § 74.177. As added § 74.175 and the newly redesignated and revised § 74.176 reads as follows:

§ 74.175 For-profit organizations other than for-profit hospitals.

(a) The principles to be used in determining the allowable costs of activities conducted by for-profit organizations (other than for-profit hospitals) are contained in the Federal Procurement Regulations at 41 CFR Subpart 1–15.2. *Exception:* Independent research and development costs

(including the indirect costs allocable to them) are unallowable. Independent research and development are defined in the Federal Procurement Regulations at 41 CFR 1–15.205–35.

(b) For hospitals, see § 74.173.

§ 74.176 Subgrants and cost-type contracts.

The cost principles applicable to a subgrantee or cost-type contractor under an HHS grant will not necessarily be the same as those applicable to the grantee. For example, where a State government awards a subgrant or cost-type contract to an institution of higher education, OMB Circular No. A–21 will apply to the costs incurred by the institution of higher education even though OMB Circular No. A–87 will apply to the costs incurred by the State.

§ 74.177 [Redesignated from § 74.176]

15. Subparts U through Z are reserved, and a new Subpart AA is added as follows:

Subparts U Through Z—[Reserved]

Subpart AA—Special Provisions for Grants and Subgrants to For-Profit Organizations

Sec.

74.701 Scope of subpart.
74.705 Prohibition against profit.
74.710 Real property, equipment, and supplies.
74.715 General program income.
74.720 Cost sharing under research grants.

Subparts U Through Z—[Reserved]

Subpart AA—Special Provisions for Grants and Subgrants to For-Profit Organizations

§ 74.701 Scope of subpart.

(a) This subpart contains provisions that apply to grants and subgrants to for-profit organizations. These provisions are in addition to other applicable portions of this part, or they make exceptions for awards to for-profit organizations from other provisions of this part.

b. This subpart also draws attention to, or discusses, provisions elsewhere in this part that need special emphasis or clarification with respect to awards to for-profit organizations.

§ 74.705 Prohibition against profit.

Attention is directed to § 74.170, which provides, in effect, that no grant funds may be paid as profit to any recipient of a grant or subgrant, even if the recipient is a for-profit organization. Profit is any amount in excess of allowable direct and indirect costs of the recipient.

§ 74.710 Real propety, equipment, and supplies.

(a) *Scope.* (1) This section applies to real property, equipment, and supplies which, in accordance with § 74.130, would be subject to Subpart O of this part but is acquired under a grant or subgrant to a for-profit organization.

(2) A grantee that is not a for-profit organization may take title to property acquired under a subgrant to a for-profit organization. If so, the property will be considered as acquired by the grantee under its grant, and this section will not apply to the property.

(b) *Applicable rules.* (1) Property subject to this section is exempt from Subpart O of this part. Instead, the clause entitled "Government Property" in 41 CFR 1–7.203–21(a) is deemed to be in every grant or subgrant to a for-profit organization, and the provisions in that clause that apply to property acquired for the Government apply to property subject to this section. For this purpose, the terms "contract" and its derivatives in that clause are considered to refer to the grant or subgrant under which the property is acquired, "subcontract" and its derivatives to refer to any subaward under that grant or subgrant, and "contracting Officer" to refer to the HHS grants officer.

(2) Records subject to the Government Property clause are exempt from Subpart D of this part.

(c) *Approval for acquisition.* A recipient shall not acquire property to be subject to this section without the prior approval of the granting agency.

§ 74.715 General program income.

The additional costs alternative described in § 74.42(e) of this part may not be applied to general program income earned by a recipient that is a for-profit organization.

§ 74.720 Cost sharing under research grants.

Under research grants to for-profit organizations, HHS does not enter into institutional cost-sharing agreements that cover all or a number of its research project grants to the grantee in the aggregate. In research grants to these organizations, HHS implements statutory requirements for cost sharing through separate cost-sharing agreements negotiated for each research project.

PART 74—[Amended]

1. The authority citation for Part 74 is revised to read as follows:

Authority: 5 U.S.C. 301; sec. 74.62(a) and Appendix J also issued under sec. 7505, Pub. L. 98-502, 98 Stat. 2333 (31 U.S.C. 7505).

2. In § 74.62, paragraph (a) is revised to read as follows:

§74.62 Non-Federal audits.

(a) *Governmental recipients*—(1) *Fiscal periods of recipients beginning before January 1, 1985.* Recipients that are governments shall comply with the requirements concerning non-Federal audits in OMB Circular A-102, including any amendments to those requirements published in the **Federal Register** by OMB.[1]

(2) *Fiscal periods of recipients beginning on or after January 1, 1985.* Recipients that are governments shall comply with OMB Circular A-128, including any amendments published in the **Federal Register** by OMB. The Circular is codified verbatim as Appendix J to this part.

(3) *Submission of audit reports.* All copies of audit reports that a recipient is required under OMB Circular A-128 to submit to HHS shall be addressed to the HHS Regional Inspector General for Audit responsible for the HHS region in which the recipient is located. The HHS Office of Inspector General will distribute copies as appropriate within the Department. Recipients therefore are not required to send their audit reports to any HHS officials, other than the responsible Regional Inspector General for Audit.

* * * * *

Appendix I—[Reserved]

3. Appendix I is added and reserved.

4. Appendix J is added to read as follows:

Appendix J—OMB Circular A-128, "Audits of State and Local Governments"

Circular No. A-128

April 12, 1985.

To the Heads of Executive Departments and Establishments

Subject: Audits of State and Local Governments.

1. *Purpose.* This Circular is issued pursuant to the Single Audit Act of 1984, Pub. L. 98-502. It establishes audit requirements for State and local governments that receive Federal aid, and defines Federal responsibilities for implementing and monitoring those requirements.

2. *Supersession.* The Circular supersedes Attachment P, "Audit Requirements," of Circular A-102, "Uniform requirements for grants to State and local governments."

3. *Background.* The Single Audit Act builds upon earlier efforts to improve audits of Federal aid programs. The Act requires State or local governments that receive $100,000 or more a year in Federal funds to have an audit made for that year. Section 7505 of the Act requires the Director of the Office of Management and Budget to prescribe policies, procedures and guidelines to implement the Act. It specifies that the Director shall designate "cognizant" Federal agencies, determine criteria for making appropriate charges to Federal programs for the cost of audits, and provide procedures to assure that small firms or firms owned and controlled by disadvantaged individuals have the opportunity to participate in contracts for single audits.

4. *Policy.* The Single Audit Act requires the following:

a. State or local governments that receive $100,000 or more a year in Federal financial assistance shall have an audit made in accordance with this Circular.

b. State or local governments that receive between $25,000 and $100,000 a year shall have an audit made in accordance with this Circular, or in accordance with Federal laws and regulations governing the programs they participate in.

c. State or local governments that receive less than $25,000 a year shall be exempt from compliance with the Act and other Federal audit requirements. These State and local governments shall be governed by audit requirements prescribed by State or local law or regulation.

d. Nothing in this paragraph exempts State or local governments from maintaining records of Federal financial assistance or from providing access to such records to Federal agencies, as provided for in Federal law or in Circular A-102, "Uniform requirements for grants to state or local governments."

5. *Definitions.* For the purposes of this Circular the following definitions from the Single Audit Act apply:

a. "Cognizant agency" means the Federal agency assigned by the Office of Management and Budget to carry out the responsibilities described in paragraph 11 of this Circular.

b. "Federal finanical assistance" means assistance provided by a Federal agency in the form of grants, contracts, cooperative agreements, loans, loan guarantees, property, interest subsidies, insurance, or direct appropriations, but does not include direct Federal cash assistance to individuals. It includes awards received directly from Federal agencies, or indirectly through other units of States and local governments.

c. "Federal agency" has the same meaning as the term 'agency' in section 551(1) of Title 5, United States Code.

d. "Generally accepted accounting principles" has the meaning specified in the generally accepted government auditing standards.

e. "Generally accepted government auditing standards" means the *Standards For Audit of Government Organizations, Programs, Activities, and Functions,* developed by the Comptroller General, dated February 27, 1981.

f. "Independent auditor" means:

(1) A State or local government auditor who meets the independence standards specified in generally accepted government auditing standards; or

(2) A public accountant who meets such independence standards.

g. "Internal controls" means the plan of organization and methods and procedures adopted by management to ensure that:

(1) Resource use is consistent with laws, regulations, and policies;

(2) Resources are safeguarded against waste, loss, and misuse; and

(3) Reliable data are obtained, maintained, and fairly disclosed in reports.

h. "Indian tribe" means any Indian tribe, band, nation, or other organized group or community, including any Alaskan Native village or regional or village corporations (as defined in, or established under, the Alaskan Native Claims Settlement Act) that is recognized by the United States as eligible for the special programs and services provided by the United States to Indians because of their status as Indians.

i. "Local government" means any unit of local government within a State, including a county, a borough, municipality, city, town, township, parish, local public authority, special district, school district, intrastate district, council of government, and any other instrumentality of local government.

j. "Major Federal Assistance Program," as defined by Pub. L. 98-502, is described in the Attachment to this Circular.

k. "Public accountants" means those individuals who meet the qualification standards included in generally accepted government auditing standards for personnel performing government audits.

[1] OMB Circulars A-102 and A-110 are available on request from the Office of Management and Budget, Publications Room, New Executive Office Building, Washington, D.C. 20503. Here is a summary of some of the main provisions concerning non-Federal audits in those two circulars:

(1) Each recipient must have itself audited by non-Federal auditors at least every two years.

(2) The recipient's auditors must meet certain standards of independence.

(3) The audit is to be performed on an organization-wide basis, with approrpiate sampling of grant-related transactions. Awarding parties may not impose grant-by-grant (or subgrant-by-subgrant) audit requirements.

l. "State" means any State of the United States, the District of Columbia, the Commonwealth of Puerto Rico, the Virgin Islands, Guam, American Samoa, the Commonwealth of the Northern Mariana Islands, and the Trust Territory of the Pacific Islands, any instrumentality thereof, and any multi-State, regional, or interstate entity that has governmental functions and any Indian tribe.

m. "Subrecipient" means any person or government department, agency, or establishment that receives Federal financial assistance to carry out a program through a State or local government, but does not include an individual that is a beneficiary of such a program. A subreceipient may also be a direct recipient of Federal financial assistance.

6. *Scope of audit.* The Single Audit Act provides that:

a. The audit shall be made by an independent auditor in accordance with generally accepted government auditing standards covering financial and compliance audits.

b. The audit shall cover the entire operations of a State or local government or, at the option of that government, it may cover departments, agencies or establishments that received, expended, or otherwise administered Federal financial assistance during the year. However, if a State or local government receives $25,000 or more in General Revenue Sharing Funds in a fiscal year, it shall have an audit of its entire operations. A series of audits of individual departments, agencies, and establishments for the same fiscal year may be considered a single audit.

c. Public hospitals and public colleges and universities may be excluded from State and local audits and the requirements of this Circular. However, if such entities are excluded, audits of these entities shall be made in accordance with statutory requirements and the provisions of Circular A-110, "Uniform requirements for grants to universities, hospitals, and other nonprofit organizations."

d. The auditor shall determine whether:

(1) The financial statements of the government, department, agency or establishment present fairly its financial position and the results of its financial operations in accordance with generally accepted accounting principles;

(2) The organization has internal accounting and other control systems to provide reasonable assurance that it is managing Federal financial assistance programs in compliance with applicable laws and regulations; and

(3) The organization has complied with laws and regulations that may have material effect on its financial statements and on each major Federal assistance program.

7. *Frequency of audit.* Audits shall be made annually unless the State or local government has, by January 1, 1987, a constitutional or statutory requirement for less frequent audits. For those governments, the cognizant agency shall permit biennial audits, covering both years, if the government so requests. It shall also honor requests for biennial audits by governments that have an administrative policy calling for audits less frequent than annual, but only for fiscal years beginning before January 1, 1987.

8. *Internal control and compliance reviews.* The Single Audit Act requires that the independent auditor determine and report on whether the organization has internal control systems to provide reasonable assurance that it is managing Federal assistance programs in compliance with applicable laws and regulations.

a. *Internal control review.* In order to provide this assurance the auditor must make a study and evaluation of internal control systems used in administering Federal assistance programs. The study and evaluation must be made whether or not the auditor intends to place reliance on such systems. As part of this review, the auditor shall:

(1) Test whether these internal control systems are functioning in accordance with prescribed procedures.

(2) Examine the receipient's system for monitoring subrecipients and obtaining and acting on subrecipient audit reports.

b. *Compliance review.* The law also requires the auditor to determine whether the organization has complied with laws and regulations that may have a material effect on each major Federal assistance program.

(1) In order to determine which major programs are to be tested for compliance, State and local governments shall identify in their accounts all Federal funds received and expended and the programs under which they were received. This shall include funds received directly from Federal agencies and through other State and local governments.

(2) The review must include the selection and testing of a representative number of charges from each major Federal assistance program. The selection and testing of transactions shall be based on the auditor's professional judgment considering such factors as the amount of expenditures for the program and the individual awards; the newness of the program or changes in its conditions; prior experience with the program, particularly as revealed in audits and other evaluations (e.g., inspections program reviews); the extent to which the program is carried out through subrecipients; the extent to which the program contracts for goods or services; the level to which the program is already subject to program reviews or other forms of independent oversight; the adequacy of the controls for ensuring compliance; the expectation of adherence or lack of adherence to the applicable laws and regulations; and the potential impact of adverse findings.

(a) In making the test of transactions, the auditor shall determine whether:

—The amounts reported as expenditures were for allowable services, and

—The records show that those who received services or benefits were eligible to receive them.

(b) In addition to transaction testing, the auditor shall determine whether:

—Matching requirements, levels of effort and earmarking limitations were met.

—Federal financial reports and claims for advances and reimbursements contain information that is supported by the books and records from which the basic financial statements have been prepared, and

—Amounts claimed or used for matching were determined in accordance with OMB Circular A-87, "Cost principles for State and local governments," and Attachment F of Circular A-102, "Uniform requirements for grants to State and local governments."

(c) The principal compliance requirements of the largest Federal aid programs may be ascertained by referring to the *Compliance Supplement for Single Audits of State and Local Governments*, issued by OMB and available from the Government Printing Office. For those programs not covered in the Compliance Supplement, the auditor may ascertain compliance requirements by researching the statutes, regulations, and agreements governing individual programs.

(3) Transactions related to other Federal assistance programs that are selected in connection with examinations of financial statements and evaluations of internal controls shall be tested for compliance with Federal laws and regulations that apply to such transactions.

9. *Subrecipients.* State or local governments that receive Federal financial assistance and provide $25,000 or more of it in a fiscal year to a subrecipient shall:

a. Determine whether State or local subrecipients have met the audit requirements of this Circular and whether subrecipients covered by Circular A-110, "Uniform requirements for grants to universities, hospitals, and other nonprofit organizations," have met that requirement;

b. Determine whether the subrecipient spent Federal assistance funds provided in accordance with applicable laws and regulations. This may be accomplished by reviewing an audit of the subrecipient made in accordance with this Circular, Circular A-110, or through other means (e.g., program reviews) if the subrecipient has not yet had such an audit;

c. Ensure that appropriate corrective action is taken within six months after receipt of the audit report in instances of noncompliance with Federal laws and regulations;

d. Consider whether subrecipient audits necessitate adjustment of the recipient's own records; and

e. Require each subrecipient to permit independent auditors to have access to the records and financial statements as necessary to comply with this Circular.

10. *Relation to other audit requirements.* The Single Audit Act provides that an audit made in accordance with this Circular shall be in lieu of any financial or financial compliance audit required under individual Federal assistance programs. To the extent that a single audit provides Federal agencies with information and assurances they need to carry out their overall responsibilities, they shall rely upon and use such information. However, a Federal agency shall make any additional audits which are necessary to carry out its responsibilities under Federal law and regulation. Any additional Federal audit effort shall be planned and carried out in such a way as to avoid duplication.

a. The provisions of this Circular do not limit the authority of Federal agencies to

make, or contract for audits and evaluations of Federal financial assistance programs, nor do they limit the authority of any Federal agency Inspector General or other Federal audit official.

b. The provisons of this Circular do not authorize any State or local government or subrecipient thereof to constrain Federal agencies, in any manner, from carrying out additional audits.

c. A Federal agency that makes or contracts for audits in addition to the audits made by recipients pursuant to this Circular shall, consistent with other applicable laws and regulations, arrange for funding the cost of such additional audits. Such additional audits include economy and efficiency audits, program results audits, and program evaluations.

11. *Cognizant agency responsibilities.* The Single Audit Act provides for cognizant Federal agencies to oversee the implementation of this Circular.

a. The Office of Management and Budget will assign cognizant agencies for States and their subdivisions and larger local governments and their subdivisions. Other Federal agencies may participate with an assigned cognizant agency, in order to fulfill the cognizance responsibilities. Smaller governments not assigned a cognizant agency will be under the general oversight of the Federal agency that provides them the most funds whether directly or indirectly.

b. A cognizant agency shall have the following responsibilities:

(1) Ensure that audits are made and reports are received in a timely manner and in accordance with the requirements of this Circular.

(2) Provide technical advice and liaison to State and local governments and independent auditors.

(3) Obtain or make quality control reviews of selected audits made by non-Federal audit organizations, and provide the results, when appropriate, to other interested organizations.

(4) Promptly inform other affected Federal agencies and appropriate Federal law enforcement officials of any reported illegal acts or irregularities. They should also inform State or local law enforcement and prosecuting authorities, if not advised by the recipient, of any violation of law within their jurisdiction.

(5) Advise the recipient of audits that have been found not to have met the requirements set forth in this Circular. In such instances, the recipient will be expected to work with the auditor to take corrective action. If corrective action is not taken, the cognizant agency shall notify the recipient and Federal awarding agencies of the facts and make recommendations for followup action. Major inadequacies or repetitive substandard performance of independent auditors shall be referred to appropriate professional bodies for disciplinary action.

(6) Coordinate, to the extent practicable, audits made by or for Federal agencies that are in addition to the audits made pursuant to this Circular; so that the additional audits build upon such audits.

(7) Oversee the resolution of audit findings that affect the programs of more than one agency.

12. *Illegal acts or irregularities.* If the auditor becomes aware of illegal acts or other irregularities, prompt notice shall be given to recipient management officials above the level of involvement. (see also paragraph 13(a)(3) below for the auditor's reporting responsibilities.) The recipient, in turn, shall promptly notify the cognizant agency of the illegal acts or irregularities and of proposed and actual actions, if any. Illegal acts and irregularities include such matters as conflicts of interest, falsification of records or reports, and misappropriations of funds or other assets.

13. *Audit Reports.* Audit reports must be prepared at the completion of the audit. Reports serve many needs of State and local governments as well as meeting the requirements of the Single Audit Act.

a. The audit report shall state that the audit was made in accordance with the provisions of this Circular. The report shall be made up of at least:

(1) The auditor's report on financial statements and on a schedule of Federal assistance; the financial statements; and a schedule of Federal assistance, showing the total expenditures for each Federal assistance program as identified in the *Catalog of Federal Domestic Assistance.* Federal programs or grants that have not been assigned a catalog number shall be identified under the caption "other Federal assistance."

(2) The auditor's report on the study and evaluation of internal control systems must identify the organization's significant internal accounting controls, and those controls designed to provide reasonable assurance that Federal programs are being managed in compliance with laws and regulations. It must also identify the controls that were evaluated, the controls that were not evaluated, and the material weaknesses identified as a result of the evaluation.

(3) The auditor's report on compliance containing:

—A statement of positive assurance with respect to those items tested for compliance, including compliance with law and regulations pertaining to financial reports and claims for advances and reimbursements;

—Negative assurance on those items not tested;

—A summary of all instances of noncompliance; and

—An identification of total amounts questioned, if any, for each Federal assistance award, as a result of noncompliance.

b. The three parts of the audit report may be bound into a single report, or presented at the same time as separate documents.

c. All fraud abuse, or illegal acts or indications of such acts, including all questioned costs found as the result of these acts that auditors become aware of, should normally be covered in a separate written report submitted in accordance with paragraph 13f.

d. In addition to the audit report, the recipient shall provide comments on the findings and recommendations in the report, including a plan for corrective action taken or planned and comments on the status of corrective action taken on prior findings. If corrective action is not necessary, a statement describing the reason it is not should accompany the audit report.

e. The reports shall be made available by the State or local government for public inspection within 30 days after the completion of the audit.

f. In accordance with generally accepted government audit standards, reports shall be submitted by the auditor to the organization audited and to those requiring or arranging for the audit. In addition, the recipient shall submit copies of the reports to each Federal department or agency that provided Federal assistance funds to the recipient. Subrecipients shall submit copies to recipients that provided them Federal assistance funds. The reports shall be sent within 30 days after the completion of the audit, but no later than one year after the end of the audit period unless a longer period is agreed to with the cognizant agency.

g. Recipients of more than $100,000 in Federal funds shall submit one copy of the audit report within 30 days after issuance to a central clearinghouse to be designated by the Office of Management and Budget. The clearinghouse will keep completed audits on file and follow up with State and local governments that have not submitted required audit reports.

h. Recipients shall keep audit reports on file for three years from their issuance.

14. *Audit Resolution.* As provided in paragraph 11, the cognizant agency shall be responsible for monitoring the resolution of audit findings that affect the programs of more than one Federal agency. Resolution of findings that relate to the programs of a single Federal agency will be the responsibility of the recipient and that agency. Alternate arrangements may be made on a case-by-case basis by agreement among the agencies concerned.

Resolution shall be made within six months after receipt of the report by the Federal departments and agencies. Corrective action should proceed as rapidly as possible.

15. *Audit workpapers and reports.* Workpapers and reports shall be retained for a minimum of three years from the date of the audit report, unless the auditor is notified in writing by the cognizant agency to extend the retention period. Audit workpapers shall be made available upon request to the cognizant agency or its designee or the General Accounting Office, at the completion of the audit.

16. *Audit Costs.* The cost of audits made in accordance with the provisions of this Circular are allowable charges to Federal assistance programs.

a. The charges may be considered a direct cost or an allocated indirect cost, determined in accordance with the provision of Circular A-87, "Cost principles for State and local governments."

b. Generally, the percentage of costs charged to Federal assistance programs for a single audit shall not exceed the percentage that Federal funds expended represent of total funds expended by the recipient during the fiscal year. The percentage may be exceeded, however, if appropriate

documentation demonstrates higher actual cost.

17. *Sanctions.* The Single Audit Act provides that no cost may be charged to Federal assistance programs for audits required by the Act that are not made in accordance with this Circular. In cases of continued inability or unwillingness to have a proper audit, Federal agencies must consider other appropriate sanctions including:

—Withholding a percentage of assistance payments until the audit is completed satisfactorily,
—Withholding or disallowing overhead costs, and
—Suspending the Federal assistance agreement until the audit is made.

18. *Auditor Selection.* In arranging for audit services State and local governments shall follow the procurement standards prescribed by Attachment O of Circular A-102, "Uniform requirements for grants to State and local governments." The standards provide that while recipients are encouraged to enter into intergovernmental agreements for audit and other services, analysis should be made to determine whether it would be more economical to purchase the services from private firms. In instances where use of such intergovernmental agreements are required by State statutes (e.g., audit services) these statutes will take precedence.

19. *Small and Minority Audit Firms.* Small audit firms and audit firms owned and controlled by socially and economically disadvantaged individuals shall have the maximum practicable opportunity to participate in contracts awarded to fulfill the requirements of this Circular. Recipients of Federal assistance shall take the following steps to further this goal:

a. Assure that small audit firms and audit firms owned and controlled by socially and economically disadvantaged individuals are used to the fullest extent practicable.

b. Make information on forthcoming opportunities available and arrange timeframes for the audit so as to encourage and facilitate participation by small audit firms and audit firms owned and controlled by socially and economically disadvantaged individuals.

c. Consider in the contract process whether firms competing for larger audits intend to subcontract with small audit firms and audit firms owned and controlled by socially and economically disadvantaged individuals.

d. Encourage contracting with small audit firms or audit firms owned and controlled by socially and economically disadvantaged individuals which have traditionally audited government programs and, in such cases where this is not possible, assure that these firms are given consideration for audit subcontrating opportunities.

e. Encourage contracting with consortiums of small audit firms as described in paragraph (a)-above when a contract is too large for an individual small audit firm or audit firm owned and controlled by socially and economically disadvantaged individuals.

f. Use the services and assistance, as appropriate, of such organizations as the Small Business Administration in the solicitation and utilization of small audit firms or audit firms owned and controlled by socially and economically disadvantaged individuals.

20. *Reporting.* Each Federal agency will report to the Director of OMB on or before March 1, 1987, and annually thereafter on the effectiveness of State and local governments in carrying out the provisions of this Circular. The report must identify each State or local government or Indian tribe that, in the opinion of the agency, is failing to comply with Circular.

21. *Regulations.* Each Federal agency shall include the provisions of this Circular in its regulations implementing the Single Audit Act.

22. *Effective date.* This Circular is effective upon publication and shall apply to fiscal years of State and local governments that begin after December 31, 1984. Earlier implementation is encouraged. However, until it is implemented, the audit provisions of Attachment P to Circular A-102 shall continue to be observed.

23. *Inquiries.* All questions or inquiries should be addressed to Financial Management Division, Office of Management and Budget, telephone number 202/395-3993.

24. *Sunset review date.* This Circular shall have an independent policy review to ascertain its effectiveness three years from the date of issuance.

David A. Stockman,

Director.

Circular A-128 Attachment

Definition of Major Program as Provided in Pub. L. 98-502

"Major Federal Assistance Program," for State and local governments having Federal assistance expenditures between $100,000 and $100,000,000, means any program for which Federal expenditures during the applicable year exceed the larger of $300,000, or 3 percent of such total expenditures.

Where total expenditures of Federal assistance exceed $100,000,000, the following criteria apply:

Total expenditures of Federal financial assistance for all programs		Major Federal assistance program means any program that exceeds
More than	But less than	
$100 million	1 billion	$3 million
1 billion	2 billion	4 million
2 billion	3 billion	7 million
3 billion	4 billion	10 million
4 billion	5 billion	13 million
5 billion	6 billion	16 million
6 billion	7 billion	19 million
Over 7 billion		20 million

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ATTACHMENT B
HDS Programs Covered/Not Covered By Executive Order 12372

HDS PROGRAMS AND ACTIVITIES COVERED BY EXECUTIVE ORDER 12372

CFDA Number	DISCRETIONARY GRANTS	MANDATORY OR FORMULA GRANTS
13.600	Head Start - Basic Head Start Program, Research, Training & Technical Assistance, Demonstration, & Pilot Projects	
13.623	Runaway Youth - All projects	
13.630		* Developmental Disabilities - Basic Support; Protection and Advocacy
13.631	Developmental Disabilities Special Projects	
13.633		* Aging - Title III-A & III-B, Grants for Supportive Services & Senior Centers
13.635		* Aging - Title III-C, Nutrition Services
13.645		* Child Welfare Services - Title IV-B State Grants
13.646	Work Incentive Program Discretionary Projects	* Work Incentive Program (WIN)
13.669		Child Abuse and Neglect State Grants
13.670	Child Abuse and Neglect Discretionary Projects	

*Excluded from the "accommodate or explain rule"

HDS PROGRAMS AND ACTIVITIES NOT COVERED BY EXECUTIVE ORDER 12372

CFDA Number	DISCRETIONARY GRANTS	MANDATORY OR FORMULA GRANTS
13.608	Child Welfare Research & Demonstration Section 426 of Social Security Act (SSA)	
13.612	Native American Programs - Financial Assistance Grants	
13.632	Developmental Disabilities - University Affiliated Facilities & Satellite Centers	
13.647	Social Services Research & Demonstration Section 1110 of Social Security Act	
13.648	Child Welfare Services (426) Training	
13.652	Adoption Opportunities - Research & Demonstration	
13.655	Aging - Title VI Grants to Indian Tribes	
13.658		Title IV-E - Foster Care
13.659		Title IV-E - Adoption Assistance
13.661	Native American Programs - Research, Demonstration & Evaluation	
13.662	Native American Programs - Training & Technical Assistance	
13.667		Social Services Block Grant
13.668	Aging - Title IV Research, Demonstration & Training	

ATTACHMENT C
Cost Principles

- **OMB Circular A-21** C-3
- **OMB Circular A-87** C-21
- **OMB Circular A-122** C-29
- **Appendix E to 45 CFR Part 74** C-45
- **Federal Acquisition Regulation 48 CFR Subpart 31.2** C-63

federal register

TUESDAY, MARCH 6, 1979

PART III

OFFICE OF MANAGEMENT AND BUDGET

CIRCULAR A-21

Cost Principles For Educational Institutions

OFFICE OF MANAGEMENT AND BUDGET

CIRCULAR A-21—COST PRINCIPLES FOR EDUCATIONAL INSTITUTIONS

This notice revises Federal Management Circular 73-8. It will be renumbered OMB Circular No. A-21. The revision originated from recommendations made by the Department of Health, Education, and Welfare after urging by the House and Senate Appropriations Committees.

On March 10, 1978, the Office of Management and Budget published a proposed revision in the FEDERAL REGISTER for comment. In response to the publication, we received approximately 300 letters from Members of Congress, Federal agencies, university administrators, faculty members, professional associations, and members of the public.

There follows a summary of the major comments grouped by subject, and a response to each, including a description of any changes made as a result of the comment. In addition to the changes described specifically, other changes have been made to improve clarity, readability, and precision; and to reduce the burden of compliance as much as possible.

For further information, contact Mr. John J. Lordan, Chief, Financial Management Branch, Office of Management and Budget, New Executive Office Building, 726 Jackson Place, N.W., Washington, D.C. 20503, (202) 395-6823.

PURPOSE

Comment. Several commentators pointed out that the proposed revision contained too much detail, and that it seemed to establish cost accounting procedures and instructions, rather than cost accounting principles.

Response. In our opinion, the revision does not change the fundamental nature of the Circular. It provised for more consistent treatment of costs, and clarifies many provisions that were considered too vague and which left the way open to widely varying interpretations. This subject is covered in more detail below in specific comments on other sections of the Circular.

Comment. Several commentators had a favorable reaction to the provision which says that agencies are not expected to place additional restrictions on individual items of cost.

Response. This provision remains in the Circular.

APPLICABILITY

Comment. Several commentators agreed with the provision which extends regulations of the Cost Accounting Standards Board to federally funded research and development centers operated by universities. This was a coordinated action with the CASB, which has exempted other work at universities from coverage.

Response. This provision remains in the Circular.

EFFECTIVE DATE

Comment. Several commentators pointed out the need for adequate time for implementation. Some suggested a two-year transition period.

Response. The Circular now establishes an effective date of October 1, 1979, and says that implementation will begin in the institution's first fiscal year beginning after that date. This can be speeded up or extended with the agreement of the cognizant Federal agency. We would expect this provision to be used to assure an orderly phase in of new provisions such as the accounting for tuition remission and specialized service facilities.

DEFINITION OF TERMS

Comment. Many commentators stated that "other sponsored activities" should not include agricultural extension programs, which had been cited as an example.

Response. This example has been removed from the Circular and we are now studying a request to exempt this program from coverage by the Circular.

INDIRECT COSTS

Comment. Many commentators objected to the inclusion of a standard allocation method to be used for each of the categories of indirect cost.

Response. The Circular has been revised to more clearly state that the standard allocation method is used only in the absence of a cost analysis study, or a mutual agreement between the institution and the cognizant agency on use of a different method.

Comment. Several commentators argued that it was inequitable to allocate depreciation on certain capital improvements on a standard base of unweighted headcount of students and employees.

Response. The unweighted headcount base has been replaced by a full-time equivalent base.

Comment. As proposed, the modified total direct cost base consisted of salaries and wages, fringe benefits, materials and supplies, travel, and subgrants and subcontracts up to $5,000 each. Several commentators proposed an increase in the dollar level of subgrants and subcontracts. Suggestions ranged from $10,000 to $50,000.

Response. The amount has been raised to $25,000.

Comment. A number of commentators objected to the use of the number of sponsored agreements as the standard base for allocating the costs of sponsored projects administration.

Response. The standard allocation base has been changed to modified total direct costs.

LIBRARY EXPENSES

Comment. Many commentators objected to the unweighted headcount base for allocating library expenses.

Response. The unweighted headcount base has been changed to the full-time equivalent base.

STUDENT ADMINISTRATION AND SERVICES

Comment. Several commentators objected that the Circular would not recognize student administration and service costs as applicable to the sponsored agreements. They contended that these services benefit all students, including those employed by the institution.

Response. The standard base for allocating student service costs would call for allocation to the instruction function, and subsequently to any sponsored agreement in that function.

DETERMINATION AND APPLICATION OF INDIRECT COSTS OR RATES

Comment. Several commentators objected to the use of modified total direct cost as the standard base for allocating indirect costs to sponsored agreements.

Response. The definition has been modified to include all subgrants and subcontracts up to $25,000 each.

COMPENSATION FOR PERSONAL SERVICES

Comment. Several commentators objected to the frequency of personnel activity reports.

Response. Compared to present requirements, frequency has been reduced from monthly to once an academic term. Also, the Circular has been clarified to explain that employees whose salaries and wages are not charged direct, or not involved in the distribution of indirect costs would not be included in the reporting system.

Comment. Several commentators criticized applying the monitored workload system only to professional employees.

Response. Introducing the monitored workload concept for professional employees recognizes that their activities cannot be measured with the same degree of accuracy as nonprofessionals. We believe that the monitored workload alternative represents a good balance between reducing paperwork and achieving an acceptable level of accountability.

DEPRECIATION AND USE ALLOWANCES

Comment. Several commentators stated that the requirement for a

physical equipment inventory every two years was burdensome.

Response. The two-year inventory requirement remains. However, it has been clarified to recognize that statistical sampling techniques may be used in making the inventory. We believe an institution wishing to recover depreciation or use allowances on equipment must take the normal business precaution of assuring by physical inventory that the equipment is still on hand.

EQUIPMENT AND OTHER CAPITAL EXPENDITURES

Comment. Many commentators recommeded that the definition of equipment be changed from an acquisition cost of $300 and a useful life of more than one year. The most common suggestion was $500 and a useful life of more than two years.

Response. The Circular has been amended to define equipment as tangible personal property having a useful life of more than two years and an acquisition cost of $500 or more per unit.

SCHOLARSHIPS AND STUDENT AID COSTS

Comment. Some commentators objected to the provision that tuition remission for student employees be treated as a direct charge to sponsored agreements.

Response. The Circular would not prohibit tuition remission as an indirect cost in all cases. It would require that tuition remission be treated as a direct or indirect cost in accordance with the actual work being performed. This is consistent with the general rules stated earlier in the Circular and with basic principles of cost accounting.

Comment. Some commentators stated that the tuition remission provision would discriminate against out-of-state students. Since the tuition they would ordinarily pay at State universities is higher than that of in-state students, their remission would be higher, thereby encouraging research faculty to favor in-state graduate assistants.

Response. The Circular has been modified to permit tuition remission to be charged on an average rate basis.

SPECIALIZED SERVICE FACILITIES

Comment. Many commentators objected to the inclusion of "animal resources centers" as a specialized service facility.

Response. "Animal resource centers" has been deleted as an example, but may be treated as a specialized service facility as circumstances dictate at each institution.

Comment. Many commentators cited the possibility that including indirect costs in the charges for specialized service facilities might raise the apparent cost of the services to such a high level that research faculty would decline to use them. They also cited unique situations where it might be appropriate to recover less than the full cost of a specialized service facility.

Response. The Circular provides that normally charges for these services should include both direct and indirect costs. It allows for exclusion of indirect costs where not material in amount.

VELMA N. BALDWIN,
Assistant to the Director for Administration.

EXECUTIVE OFFICE OF THE PRESIDENT,
OFFICE OF MANAGEMENT AND BUDGET,
Washington, D.C., February 26, 1979.

[Circular No. A-21, Revised]

To the Heads of Executive Departments and Establishments.

Subject: Cost principles for educational institutions.

1. *Purpose.* This circular establishes principles for determining costs applicable to grants, contracts, and other agreements with educational institutions. The principles deal with the subject of cost determination, and make no attempt to identify the circumstances or dictate the extent of agency and institutional participation in the financing of a particular project. The principles are designed to provide that the Federal Government bear its fair share of total costs, determined in accordance with generally accepted accounting principles, except where restricted or prohibited by law. Agencies are not expected to place additional restrictions on individual items of cost. Provision for profit or other increment above cost is outside the scope of this Circular.

2. *Supersession.* The Circular supersedes Federal Management Circular 73-8, dated December 19, 1973. FMC 73-8 is revised and reissued under its original designation of OMB Circular No. A-21.

3. *Applicability.*

a. All Federal agencies that sponsor research and development, training, and other work at educational institutions shall apply the provisions of this Circular in determining the costs incurred for such work. The principles shall also be used as a guide in the pricing of fixed price or lump sum agreements.

b. In addition, Federally Funded Research and Development Centers associated with educational institutions shall be required to comply with the Cost Accounting Standards, rules and regulations issued by the Cost Accounting Standards Board, and set forth in 4 CFR Ch. III; provided that they are subject thereto under defense related contracts.

4. *Responsibilities.* The successful application of cost accounting principles requires development of mutual understanding between representatives of educational institutions and of the Federal Government as to their scope, implementation, and interpretation.

5. *Attachment.* The priniciples and related policy guides are set forth in the Attachment, "Principles for determining costs applicable to grants, contracts, and other agreements with educational institutions."

6. *Effective date.* The provisions of this Circular shall be effective October 1, 1979. The provisions shall be implemented by institutions as of the start of their first fiscal year beginning after that date. Earlier implementation, or a delay in implementation of individual provisions, is permitted by mutual agreement between an institution and the cognizant Fedral agency.

7. *Inquiries.* Further information concerning this Circular may be obtained by contacting the Financial Management Branch, Budget Review Division, Office of Management and Budget, Washington, D.C. 20503, telephone (202) 395-6823.

JAMES T. McINTYRE, Jr.,
Director.

PRINCIPLES FOR DETERMINING COSTS APPLICABLE TO GRANTS, CONTRACTS, AND OTHER AGREEMENTS WITH EDUCATIONAL INSTITUTIONS

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29. Public information services costs.
30. Rearrangement and alteration costs.
31. Reconversion costs.
32. Recruiting costs.
33. Rental cost of buildings and equipment.
34. Royalties and other costs for use of patents.
35. Sabbatical leave costs.
36. Scholarships and student aid costs.
37. Severance pay.
38. Specialized service facilities.
39. Special services costs.
40. Student activity costs.
41. Taxes.
42. Transportation costs.
43. Travel costs.
44. Termination costs applicable to sponsored agreements.

K. CERTIFICATION OF CHARGES

PRINCIPLES FOR DETERMINING COSTS APPLICABLE TO GRANTS, CONTRACTS, AND OTHER AGREEMENTS WITH EDUCATIONAL INSTITUTIONS

A. PURPOSE AND SCOPE

1. *Objective.* This Attachment provides principles for determning the costs applicable to research and development, training, and other sponsored work performed by colleges and universities under grants, contracts, and other agreements with the Federal Government. These agreements are referred to as sponsored agreements.

2. *Policy guides.* The successful application of these cost accounting principles requires development of mutual understanding between representatives of universities and of the Federal Government as to their scope, implementation, and interpretation. It is recognized that—

a. The arrangements for Federal agency and institutional participation in the financing of a research, tranining, or other project are properly subject to negotiation between the agency and the institution concerned, in accordance with such Government-wide criteria or legal requirements as may be applicable.

b. Each institution, possessing its own unique combination of staff, facilities, and experience, should be encouraged to conduct research and educational activities in a manner consonant with its own academic philosophies and institutional objectives.

c. The dual role of students engaged in research and the resulting benefits to sponsored agreements are fundamental to the research effort and shall be recognized in the application of these principles.

d. Each institution, in the fulfillment of its obligations, should employ sound management practices.

e. The application of these cost accounting principles should require no significant changes in the generally accepted accounting practices of colleges and universities. However, the accounting practices of individual colleges and universities must support the accumulation of costs as required by the principles, and must provide for adequate documentation to support costs charged to sponsored agreements.

f. Cognizant Federal agencies involved in negotiating indirect cost rates and auditing should assure that institutions are generally applying these cost accounting principles on a consistent basis. Where wide variations exist in the treatment of a given cost item among institutions, the reasonableness and equitableness of such treatments should be fully considered during the rate negotiations and audit.

3. *Application.* These principles shall be used in determining the allowable costs of work performed by colleges and universities under sponsored agreements. The principles shall also be used in determining the costs of work performed by such institutions under subgrants, cost-reimbursement subcontracts, and other awards made to them under sponsored agreements. They also shall be used as a guide in the pricing of fixed-price contracts and subcontracts where costs are used in determining the appropriate price. The principles do not apply to:

a. Arrangements under which Federal financing is in the form of loans, scholarships, fellowships, traineeships, or other fixed amounts based on such items as education allowance or published tuition rates and fees of an institution.

b. Capitation awards.

c. Other awards under which the institution is not required to account to the Government for actual costs incurred.

B. DEFINITION OF TERMS

1. *Major functions of an institution* refers to instruction (includes departmental research), organized research, other sponsored activities, and other institutional activities as defined below:

a. *Instruction* means the teaching and training activities of an institution. Except for research training as provided in c below, this term includes all teaching and training activities, whether they are offered for credits toward a degree or certificate or on a noncredit basis, and whether they are offered through regular academic departments or separate divisions, such as summer school division or an extension division.

b. *Departmental research* means all research and development activities that are not organized research and, consequently, are not separately budgeted and accounted for. Departmental research, for purposes of this document, is not considered as a major function of an institution but as a part of the instruction function of the institution.

c. *Organized research* means all research and development activities of an institution that are separately budgeted and accounted for. This term includes research and development activities that ase sponsored by Federal and non-Federal agencies and organizations, as well as those that are separately bedgeted by the institution under an internal allocation of institutional funds. It also includes activities involving the training of individuals in research techniques (commoly called research training) where such activities utilize the same facilities as other research and development activities, and where such activities are not included in the instruction function. The costs of organized research and development activities include all costs incurred by the institution in performing the activities.

d. *Other sponsored activities* means programs and projects financed by Federal and non-Federal agencies and organizations which involve the performance of work other than instruction and organized research. Examples of such programs and projects are health service projects, and community service programs. However, when any of these activities are undertaken by the institution without outside support, they may be classified as other institutional activities.

e. *Other institutional activities* means all activities of an institution except: (1) instruction, departmental research, organized research, and other sponsored activities, as defined above; (2) indirect cost activities indentified in Section F; and (3) specialized service facilities described in Section J38. Other institutional activities include operation of residence halls, dining halls, hospitals and clinics, student unions, intercollegiate athletics, bookstores, faculty housing, student apartment, guest houses, chapels, theaters, public museums, and other similar auxiliary enterprises. This definition also includes any other categories of activities, costs of which are "unallowable" to sponsored agreements, unless otherwise indicated in the agreements.

2. *Sponsored agreement,* for purposes of this circular, means any grant, contract, or other agreement between the institution and the Federal Government.

3. *Allocation* means the process of assigning a cost, or a group of costs, to one or more cost objective, in reasonable and realistic proportion to the benefit provided or other equitable relationship. A cost objective may be a major function of the institution, a particular service or project, a sponsored agreement, or an indirect cost activity, as described in Section F. The process may entail assigning a cost(s) directly to a final cost objective or through one or more intermediate cost objectives.

C. BASIC CONSIDERATIONS

1. *Composition of total costs.* The cost of a sponsored agreement is comprised of the allowable direct costs incident to its performance, plus the allocable portion of the allow-

able indirect costs of the institution, less applicable credits as described in 5 below.

2. *Factors affecting allowability of costs.* The tests of allowability of costs under these principles are: (a) they must be reasonable; (b) they must be allocable to sponsored agreements under the principles and methods provided herein; (c) they must be given consistent treatment through application of those generally accepted accounting principles appropriate to the circumstances; and (d) they must conform to any limitations or exclusions set forth in these principles or in the sponsored agreement as to types or amounts of cost items.

3. *Reasonable costs.* A cost may be considered reasonable if the nature of the goods or services acquired or applied, and the amount involved therefor, reflect the action that a prudent person would have taken under the circumstances prevailing at the time the decision to incur the cost was made. Major considerations involved in the determination of the reasonableness of a cost are: (a) whether or not the cost is of a type generally recognized as necessary for the operation of the institution or the performance of the sponsored agreement; (b) the restraints or requirements imposed by such factors as arm's-length bargaining, Federal and State laws and regulations, and sponsored agreement terms and conditions; (c) whether or not the individuals concerned acted with due prudence in the circumstances, considering their responsibilities to the institution, it employees, it students, the Government, and the public at large; and (d) the extent to which the actions taken with respect to the incurrence of the cost are consistent with established institutional policies and practices applicable to the work of the institution generally, including sponsored agreements.

4. *Allocable costs.*

a. A cost is allocable to a particular cost objective (i.e., a specific function, project, sponsored agreement, department, or the like) if the goods or services involved are chargeable or assignable to such cost objective in accordance with relative benefits received or other equitable relationship. Subject to the foregoing, a cost is allocable to a sponsored agreement if (1) it is incurred solely to advance the work under the sponsored agreement; (2) its benefits both the sponsored agreement and other work of the institution, in proportions that can be approximated through use of reasonable methods, or (3) it is necessary to the overall operation of the institution and, in light of the principles provided in this Circular, is deemed to be assignable in part to sponsored projects. Where the purchase of equipment or other capital items is specifically authorized under a sponsored agreement, the amounts thus authorized for such purchases are assignable to the sponsored agreement regardless of the use that may subsequently be made of the equipment or other capital items involved.

b. Any costs allocable to a particular sponsored agreement under the standards provided in this Circular may not be shifted to other sponsored agreements in order to meet deficiencies caused by overruns or other fund considerations, to avoid restrictions imposed by law or by terms of the sponsored agreement, or for other reasons of convience.

5. *Applicable credits.*

a. The term applicable credits refers to those receipts or negative expenditures that operate to offset or reduce direct or indirect cost items. Typical examples of such transactions are: purchase discounts, rebates, or allowances; recoveries or indemnites on losses; and adjustments of overpayments or erroneous charges. This term also includes "educational discounts" on products or services provided specifically to educational institutions, such as discounts on computer equipment, except where the arrangement is clearly and explicitly identified as a gift by the vendor.

b. In some instances, the amounts received from the Federal Government to finance institutional activities or service operations should be treated as applicable credits. Specifically, the concept of netting such credit items against related expenditures should be applied by the institution in determining the rates or amounts to be charged to sponsored agreements for services rendered whenever the facilities or other resources used in providing such services have been financed directly, in whole or in part, by Federal funds. (See Sections F8, J9a, and J38 for areas of potential application in the matter of direct Federal financing.)

6. *Costs incurred by State and local governments.* Costs incurred or paid by State or local governments on behalf of their colleges and universities for fringe benefit programs such as pension costs and FICA and any other costs specifically incurred on behalf of, and in direct benefit to, the institutions are allowable costs of such institutions whether or not these costs are recorded in the accounting records of the institutions, subject to the following:

a. The costs meet the requirements of C1 through 5 above.

b. The costs are properly supported by cost allocation plans in accordance with applicable Federal cost accounting principles.

c. The costs are not otherwise borne directly or indirectly by the Federal Government.

7. *Limitations on allowance of costs.* Sponsored agreements may be subject to statutory requirements that limit the allowance of costs. When the maximum amount allowable under a limitation is less than the total amount determined in accordance with the principles in this Circular, the amount not recoverable under a sponsored agreement may not be charged to other sponsored agreements.

D. DIRECT COSTS

1. *General.* Direct costs are those costs that can be identified specifically with a particular sponsored project, and instructional activity, or any other institutional activity; or that can be directly assigned to such activities relatively easily with a high degree of accuracy.

2. *Application to sponsored agreements.* Identification with the sponsored work rather than the nature of the goods and services involved is the determining factor in distinguishing direct from indirect costs of sponsored agreements. Typical costs charged directly to a sponsored agreement are the compensation of employees for performance of work under the sponsored agreement, including related fringe benefit costs to the extent they are consistently treated, in like circumstances, by the institution as direct rather than indirect costs; the costs of materials consumed or expended in the performance of the work; and other items of expense incurred for the sponsored agreement, including extraordinary utility consumption. The cost of materials supplied from stock or services rendered by specialized facilities or other institutional service operations may be included as direct costs of sponsored agreements, provided such items are consistently treated, in like circumstances, by the institution as direct rather than indirect costs, and are charged under a recognized method of computing actual costs, and conform to generally accepted cost accounting practices consistently followed by the institution.

E. INDIRECT COSTS

1. *General.* Indirect costs are those that are incurred for common or joint objectives and therefore cannot be identified readily and specifically with a particular sponsored project, and instructional activity, or any other institutional activity. At educational institutions such costs normally are classified under the following indirect cost categories: depreciation and use allowances, general administration and general expenses, sponsored projects administration expenses, operation and maintenance expenses, library expenses, departmental administration expenses, and student administration and services.

2. *Criteria for distribution.*

3. *Base period.* A base period for distribution of indirect costs is the period during which the costs are incurred. The base period normally should coincide with the fiscal year established by the institution, but in any event the base period should be so selected as to avoid inequities in the distribution of costs.

b. *Need for cost groupings.* The overall objective of the indirect cost allocation process is to distribute the indirect costs described in Section F to the major functions of the institution in proportions reasonably consistent with the nature and extent of their use of the institution's resources. In order to achieve this objective, it may be necessary to provide for selective distribution by establishing separate groupings of cost within one or more of the indirect cost categories referred to in E1 above. In general, the cost groupings established within a category should constitute, in each case, a pool of those items of expense that are considered to be of like nature in terms of their relative contribution to (or degree of remoteness from) the particular cost objectives to which distribution is appropriate. Cost groupings should be established considering the general guides provided in c below. Each such pool or cost grouping should then be distributed individually to the related cost objectives, using the distribution base or method most appropriate in the light of the guides set forth in d below.

c. *General considerations on cost groupings.* The extent to which separate cost groupings and selective distribution would be appropriate at an institution is a matter of judgment to be determined on a case-by-case basis. Typical situations which may warrant the establishment of two or more separate cost groupings (based on account classification or analysis) within an indirect cost category include but are not limited to the following:

(1) Where certain items or categories of expense relate solely to one of the major functions of the institution or to less than all functions, such expenses should be set aside as a separate cost grouping for direct assignment or selective allocation in accordance with the guides provided in E2b and d.

(2) Where any types of expense ordinarily treated as general administration or departmental administration are charged to sponsored agreements as direct costs, expenses applicable to other activities of the institution when incurred for the same purposes in like circumstances must, through separate cost groupings, be excluded from the indirect costs allocable to those sponsored agreements and included in the direct cost of other activities for cost allocation purposes.

(3) Where it is determined that certain expenses are for the support of a service unit or facility whose output is susceptible of measurement on a workload or other quantitative basis, such expenses should be set aside as a separate cost gouping for distribution on such basis to organized research, instructional, and other activities at the institution or within the department.

(4) Where activities provide their own purchasing, personnel administration, building maintenance or similar service, the distribution of general administration and general espenses, or operation and maintenance expenses to such activities should be accomplished through cost groupings which include only that portion of central indirect costs (such as for overall management) which are properly allocable to such activities.

(5) Where the institution elects to treat fringe benefits as indirect charges, such costs should be set aside as a separate cost grouping for selective distribution to related cost objectives.

(6) The number of separate cost groupings within a category should be held within practical limits, after taking into consideration the materiality of the amounts involved and the degree of precision attainable through less selective methods of distribution.

d. *Selection of distribution method.*

(1) Actual conditions must be taken into account in selecting the method or base to be used in distributing individual cost groupings. The essential consideration in selecting a base is that it be the one best suited for assigning the pool of costs to cost objectives in accordance with benefits derived; a traceable cause and effect relationship; or logic and reason, where neither benefit nor cause and effect relationship is determinable.

(2) Where a cost grouping can be identified directly with the cost objective benefited, it should be assigned to that cost objective.

(3) Where the expenses in a cost grouping are more general in nature, the distribution may be based on a cost analysis study which results in an equitable distribution of the costs. Such cost analysis studies may take into consideration weighting factors, population, or space occupied if appropriate. Cost analysis studies, however, must (a) be appropriately documented in sufficient detail for subsequent review by the cognizant Federal agency, (b) distribute the costs to the related cost objectives in accordance with the relative benefits derived, (c) be statistically sound, (d) be performed specifically at the institution at which the results are to be used, and (e) be reviewed periodically, but not less frequently than every two years, updated if necessary, and used consistently. Any assumptions made in the study must be stated and explained. The use of cost analysis studies and periodic changes in the method of cost distribution must be fully justified.

(4) If a cost analysis study is not performed, or if the study does not result in an equitable distribution of the costs, the distribution shall be made in accordance with the appropriate base cited in Section F., unless one of the following conditions is met: (a) it can be demonstrated that the use of a different base would result in a more equitable allocation of the costs, or that a more readily available base would not increase the costs charged to sponsored agreements, or (b) the institution qualifies for, and elects to use, the simplified method for computing indirect cost rates described in Section H.

e. *Order of Distribution.*

(1) Indirect cost categories consist of depreciation and use allowance, operation and maintenance, general administration and general expenses, departmental administration, sponsored projects administration, library, and student administration and services, as described in Section F.

(2) Depreciation and use allowances, operation and maintenance expenses, and general administrative and general expenses should be allocated in that order to the remaining indirect cost categories as well as to the major functions and specialized service facilities of the institution. Other cost categories may be allocated in the order determined to be most appropriate by the institutions. When cross allocation of costs is made as provided in (3) below, this order of allocation does not apply.

(3) Normally an indirect cost category will be considered closed once it has been allocated to other cost objectives, and costs may not be subsequently allocated to it. However, a cross allocation of costs between two or more indirect cost categories may be used if such allocation will result in a more equitable allocation of costs. If a cross allocation is used, an appropriate modification to the composition of the indirect cost categories described in Section F is required.

F. IDENTIFICATION AND ASSIGNMENT OF INDIRECT COSTS

1. *Depreciation and use allowances.*

a. The expenses under this heading are the portion of the costs of the institution's buildings, capital improvements to land and buildings, and equipment which are computed in accordance with Section J9.

b. In the absence of the alternatives provided for in Section E2d, the expenses included in this category shall be allocated in the following manner:

(1) Depreciation or use allowances on buildings used exclusively in the conduct of a single function, and on capital improvements and equipment used in such buildings, shall be assigned to that function.

(2) Depreciation or use allowances on buildings, used for more than one function, and on capital improvements and equipment used in such buildings, shall be allocated to the individual functions performed in each building on the basis of usable square feet of space, excluding common areas such as hallways, stairwells, and restrooms.

(3) Depreciation or use allowances on buildings and capital improvements where space is used jointly, and on equipment used jointly, shall be allocated to benefiting functions in proportion to the total salaries and wages applicable to the joint functions.

(4) Depreciation or use allowances on buildings, capital improvements, and equipment used predominantly for one function and only incidentally for other(s), may be assigned to the function in which it is used predominantly.

(5) Depreciation or use allowances on certain capital improvements to land, such as paved parking areas, fences, sidewalks, and the like, not included in the cost of buildings, shall be allocated to user categories of students and employees on a full-time equivalent basis. The amount allocated to the student category shall be assigned to the instruction function of the institution. The amount allocated to the employee category shall be further allocated to the major functions of the institution in proportion to the salaries and wages of all employees applicable to those functions.

2. *Operation and maintenance expenses.*

a. The expenses under this heading are those that have been incurred by a central service organization or at the departmental level for the administration, supervision, operation, maintenance, preservation, and protection of the institution's physical plant. They include expenses normally incurred for such items as janitorial and utility services; repairs and ordinary or normal alterations of buildings, furniture and equipment; and care of grounds and maintenance and operation of buildings and other plant facilities. The operation and maintenance expenses category should also include the fringe benefit costs applicable to the salaries and wages included therein, and depreciation and use allowance.

b. In the absence of the alternatives provided for in Section E2d, the expenses included in this category shall be allocated in the same manner as described in Section F1b for depreciation and use allowances.

3. *General administration and general expenses.*

a. The expenses under this heading are those that have been incurred for the general executive and administrative offices of educational institutions and other expenses of a general character which do not relate solely to any major function of the institution; i.e., solely to (1) instruction, (2) organized research, (3) other sponsored activities, or (4) other institutional activities. The general administration and general expense category should also include the fringe benefit costs applicable to the salaries and wages included therein, an appropriate share of operation and maintenance expense, and depreciation and use allowances.

b. In the absence of the alternatives provided for in Section E2d, the expenses included in this category shall be grouped first according to common major functions of the institution to which they render services or provide benefits. The aggregate expenses of each group shall then be allocated to serviced or benefited functions on the modified total cost basis. Modified total costs consist of salaries and wages, fringe benefits, materials and supplies, services, travel, and subgrants and subcontracts up to $25,000 each. When an activity included in this indirect cost category provides a service or product to another institution or organization, an appropriate adjustment must be made to either the expenses or the basis of allocation or both, to assure a proper allocation of costs.

4. *Departmental administration expenses.*

a. The expenses under this heading are those that have been incurred for administrative and supporting services that benefit common or joint departmental activities or

objectives in academic deans' offices, academic departments and divisions, and organized research institutes, study centers, and research centers. Departmental administration expenses are subject to the following limitations.

(1) Academic deans' offices. Salaries and operating expenses are limited to those attributable to administrative functions.

(2) Academic departments:

(a) The salaries of the heads of academic departments, divisions, and organized research units are limited to amounts attributable to their administrative duties. Salaries of professorial or professional staff, whose appointment or assignment require administrative work that benefits sponsored projects, may also be included to the extent that the portion so charged is clearly and specifically supported as required in Section J6.

(b) Other administrative and supporting expenses incurred within academic departments are allowable provided they are treated consistently in like circumstances. This would include expenses such as the salaries of secretarial and clerical staffs, the salaries of administrative officers and assistants, travel, office supplies, stockrooms, and the like.

(3) Other fringe benefit costs applicable to the salaries and wages included in (1) and (2) above are allowable, as well as an appropriate share of general administration and general expenses, operation and maintenance expenses, and depreciation and/or use allowances.

b. In the absence of the alternatives provided for in Section E2d, the expenses included in this category shall be allocated as follows:

(1) The administrative expenses of the dean's office of each college and school shall be allocated to the academic departments within that college or school on the modified total cost basis.

(2) The administrative expenses of each academic department, and the department's share of the expenses allocated in (1) above shall be allocated to the appropriate functions of the department on the modified total coast basis.

5. Sponsored projects administration.

a. The expenses under this heading are those that have been incurred by a separate organization(s) established primarily to administer sponsored projects, including such functions as grant and contract administration (Federal and Non-Federal), special security, purchasing, personnel administration, and editing and publishing of research and other reports. They include the salaries and expenses of the head of such organization, his assistants, and their immediate staff, together with the salaries and expenses of personnel engaged in supporting activities maintained by the organization, such as stock rooms, stenographic pools, and the like. The salaries of professorial or professional staff whose appointments or assignments involve the performance of such administrative work may also be included to the extent that the portion so charged to sponsored agreements administration is clearly identified and supported as required by Section J6. This category should also include the fringe benefit costs applicable to the salaries and wages included therein, an appropriate share of general administration and general expenses, the operation and maintenance expenses, and depreciation and use allowance. Appropriate adjustments should be made for services provided to other functions or organizations.

b. In the absence of the alternatives provided for in Section E2d, the expenses included in this category shall be allocated to the major functions of the institution under which the sponsored projects are conducted on the basis of the modified total cost of sponsored projects.

c. An appropriate adjustment shall be made to eliminate any duplicate charges to sponsored agreements when this category includes similar or identical activities as those included in the general administration and general expense category or other indirect cost items, such as accounting, procurement, or personnel administration.

6. Library expenses.

a. The expenses under this heading are those that have been incurred for the operation of the library, including the cost of books and library materials purchased for the library, less any items of library income that qualify as applicable credits under Section C5. The library expense category should also include the fringe benefits applicable to the salaries and wages included therein, an appropriate share of general administration and general expense, operation and maintenance expense, and depreciation and use allowances. Costs incurred in the purchases of rare books (museum-type books) with no value to sponsored agreements should not be allocated to them.

b. In the absence of the alternatives provided for in Section E2d, the expenses included in this category shall be allocated first on the basis of primary categories of users, including students, professional employees, and other users.

(1) The student category shall consist of full-time equivalent students enrolled at the institution, regardless of whether they earn credits toward a degree or certificate.

(2) The professional employee category shall consist of all faculty members and other professional employees of the institution, on a full-time equivalent basis.

(3) The other users category shall consist of all other users of library facilities.

c. Amounts allocated in b above shall be assigned further as follows: (1) The amount in the student category shall be assigned to the instruction function of the institution.

(2) The amount in the professional employee category shall be assigned to the major functions of the institution in proportion to the salaries and wages of all faculty members and other professional employees applicable to those functions.

(3) The amount in the other users category shall be assigned to the other institutional activities function of the institution.

7. Student administration and services.

a. The expenses under this heading are those that have been incurred for the administration of student affairs and for services to students, including expenses of such activities as deans of students, admissions, registrar, counseling and placement services, student advisers, student health and infirmary services, catalogs, and commencements and convocations. The salaries of members of the academic staff whose academic appointments or assignments involve the performance of such administrative or service work may also be included to the extent that the portion so charged is supported pursuant to Section J6. This expense category also includes the fringe benefit costs applicable to the salaries and wages included therein, an appropriate share of general administration and general expenses, operation and maintenance, and use allowances and/or depreciation.

b. In the absence of the alternatives provided for in Section E2d, the expenses in this category shall be allocated to the instruction function, and subsequently to sponsored agreements in that function.

8. Offset for indirect expenses otherwise provided for by the Government.

a. The items to be accumulated under this heading are the reimbursements and other payments from the Federal Government which are made to the institution to support solely, specifically, and directly, in whole or in part, any of the administ[illegible] or service activities described in F1 through 7 above.

b. The items in this group shall be treated as a credit to the affected individual indirect cost category before that category is allocated to benefiting functions.

G. DETERMINATION AND APPLICATION OF INDIRECT COST RATE OR RATES

1. Indirect cost pools.

a. Subject to b below, the separate categories of indirect costs allocated to each major function of the institution as prescribed in Section f shall be aggregated and treated as a common pool for that function. The amount in each pool shall be divided by the distribution base described in G2 below to arrive at a single indirect cost rate for each function. The rate for each function is used to distribute indirect costs to individual sponsored agreements of that function. Since a common pool established for each major function of the institution, a separate indirect cost rate would be established for each of the major functions described in Section B1 under which sponsored agreements are carried out.

b. In some instances a single rate basis for use across the board on all work within a major function at an institution may not be appropriate. A single rate for research, for example, might not take into account those different environmental factors and other conditions which may affect substantially the indirect costs applicable to a particular segment of research at the institution. A particular segment of research may be that performed under a single sponsored agreement or it may consist of research under a group of sponsored agreements performed in a common environment. The environmental factors are not limited to the physical location of the work. Other important factors are the level of the administrative support required, the nature of the facilities or other resources employed, the scientific disciplines or technical skills involved, the organizational arrangements used, or any combination thereof. Where a particular segment of a sponsored agreement is performed within an environment which appears to generate a significantly different level of indirect costs, provision should be made for a separate indirect cost pool applicable to such work. The separate indirect cost pool should be developed during the regular course of the rate determination process and the separate indirect cost rate resulting therefrom should be utilized; provided it is determined that (1) such indirect cost rate differs significantly from that which would have been obtained under a. above, and (2) the volume of work to which such rate would apply is material in relation

to other sponsored agreements at the institution.

2. *The distribution basis.* Indirect costs shall be distributed to applicable sponsored agreements on the basis of modified total direct costs, consisting of salaries and wages, fringe benefits, materials and supplies, services, travel, and subgrants and subcontracts up to $25,000 each. For this purpose, an indirect cost rate should be determined for each of the separate indirect cost pools developed pursuant to G1, above. The rate in each case should be stated as the percentage which the amount of the particular indirect cost pool is of the modified total direct costs identified with such pool. Other bases may be used where it can be demonstrated that they produce more equitable results.

3. *Negotiated lump sum for indirect costs.* A negotiated fixed amount in lieu of indirect costs may be appropriate for self-contained, off-campus, or primarily subcontracted activities where the benefits derived from an institution's indirect services cannot be readily determined. Such negotiated indirect costs will be treated as an offset before allocation to instruction, organized research, other sponsored activities, and other institutional activities. The base on which such remaining expenses are allocated should be appropriately adjusted.

4. *Predetermined fixed rates for indirect costs.* Public Law 87-638 (76 Stat. 437) authorizes the use of predetermined fixed rates in determining the indirect costs applicable under research agreements with educational institutions. The stated objectives of the law are to simplify the administration of cost-type research and development contracts (including grants) with educational institutions, to facilitate the preparation of their budgets, and to permit more expeditious closeout of such contracts when the work is completed. In view of the potential advantages offered by this procedure, consideration should be given to the negotiation of predetermined fixed rates for indirect costs in those situations where the cost experience and other pertinent facts available are deemed sufficient to enable the parties involved to reach an informed judgment as to the probable level of indirect costs during the ensuing accounting period.

5. *Negotiated fixed rates and carry-forward provisions.* When a fixed rate is negotiated in advance for a fiscal year (or other time period), the over- or under-recovery for that year may be included as an adjustment to the indirect cost for the next rate negotiation. When the rate is negotiated before the carry-forward adjustment is determined, the carry-forward amount may be applied to the next subsequent rate negotiation. When such adjustments are to be made, each fixed rate negotiated in advance for a given period will be computed by applying the expected indirect costs allocable to sponsored agreements for the forecast period plus or minus the carry-forward adjustment (over- or under-recovery) from the prior period, to the forecast distribution base. Unrecovered amounts under lump-sum agreements or cost-sharing provisions of prior years shall not be carried forward for consideration in the new rate negotiation. There must, however, be an advance understanding in each case between the institution and the cognizant Federal agency as to whether these differences will be considered in the rate negotiation rather than making the determination after the differences are known. Further, institutions electing to use this carry-forward provision may not subsequently change without prior approval of the cognizant Federal agency. In the event that an institution returns to a postdetermined rate, any over- or under-recovery during the period in which negotiated fixed rates and carry-forward provisions were followed will be included in the subsequent postdetermined rates. Where multiple rates are used, the same procedure will be applicable for determining each rate.

H. SIMPLIFIED METHOD FOR SMALL INSTITUTIONS

1. *General.*

a. Where the total direct cost of work covered by this Circular at an institution does not exceed $3,000,000 in a fiscal year, the use of the simplified procedure described in 2, below, may be used in determining allowable indirect costs. Under this simplified procedure, the institution's most recent annual financial report and immediately available supporting information with salaries and wages segregated from other costs, will be utilized as a basis for determining the indirect cost rate applicable to all sponsored agreements.

b. The simplified procedure should not be used where it produces results which appear inequitable to the Government or the institution. In any such case, indirect costs should be determined through use of the regular procedure.

2. *Simplified procedure.*

a. Establish the total amount of salaries and wages paid to all employees of the institution.

b. Establish an indirect cost pool consisting of the expenditures (exclusive of capital items and other costs specifically identified as unallowable) which customarily are classified under the following titles or their equivalents:

(1) General administration and general expenses (exclusive of costs of student administration and services, student activities, student aid, and scholarships).

(2) Operation and maintenance of physical plant; and depreciation and use allowances; after appropriate adjustment for costs applicable to other institutional activities.

(3) Library.

(4) Department administration expenses, which will be computed as 20 percent of the salaries and expenses of deans and heads of departments.

In those cases where expenditures classified under (1) above have previously been allocated to other institutional activities, they may be included in the indirect cost pool. The total amount of salaries and wages included in the indirect cost pool must be separately identified.

c. Establish a salary and wage distribution base, determined by deducting from the total of salaries and wages as established in a above the amount of salaries and wages included under b above.

d. Establish the indirect cost rate, determined by dividing the amount in the indirect cost pool, b above, by the amount of the distribution base, c above.

e. Apply the indirect cost rate to direct salaries and wages for individual agreements to determine the amount of indirect costs allocable to such agreements.

J. GENERAL PROVISIONS FOR SELECTED ITEMS OF COST

Sections 1 through 44 below provide principles to be applied in establishing the allowability of certain items involved in determining cost. These principles should apply irrespective of whether a particular item of cost is properly treated as direct cost or indirect cost. Failure to mention a particular item of cost is not intended to imply that it is either allowable or unallowable; rather determination as to allowability in each case should be based on the treatment provided for similar or related items of cost. In case of a discrepancy between the provisions of a specific sponsored agreement and the provisions below, the agreement should govern.

1. *Advertising costs.*

a. The term advertising costs means the costs of advertising media and corollary administrative costs. Advertising media include magazines, newspapers, radio and television programs, direct mail, exhibits, and the like.

b. The only advertising costs allowable are those which are solely for (1) the recruitment of personnel required for the performance by the institution of obligations arising under the sponsored agreement, when considered in conjunction with all other recruitment costs, as set forth in Section J32; (2) the procurement of goods and services for the performance of the sponsored agreement; (3) the disposal of scrap or surplus materials acquired in the performance of the sponsored agreement except when institutions are reimbursed for disposal costs at a predetermined amount in accordance with Attachment N, OMB Circular No. A-110; or (4) other specific purposes necessary to meet the requirements of the sponsored agreement.

c. Costs of this nature, if incurred for more than one sponsored agreement or for both sponsored work and other work of the institution, are allowable to the extent that the principles in Sections D and E are observed.

2. *Bad debts.* Any losses, whether actual or estimated, arising from uncollectible accounts and other claims, related collections costs, and related legal costs, are unallowable.

3. *Civil defense costs.* Civil defense costs are those incurred in planning for, and the protection of life and property against, the possible effects of enemy attack. Reasonable costs of civil defense measures (including costs in excess of normal plant protection costs, first-aid training and supplies, firefighting training, posting of additional exit notices and directions, and other approved civil defense measures) undertaken on the institution's premises pursuant to suggestions or requirements of civil defense authorities are allowable when distributed to all activities of the institution. Capital expenditures for civil defense purposes will not be allowed, but a use allowance or depreciation may be permitted in accordance with provisions set forth in Section J9. Costs of local civil defense projects not on the institution's premises are unallowable.

4. *Commencement and convocation costs.* Costs incurred for commencements and convocations are unallowable, except as provided for in Section F7.

5. *Communication costs.* Costs incurred for telephone services, local and long distance telephone calls, telegrams, radiograms, postage and the like, are allowable.

6. *Compensation for personal services*

a. *General.* Compensation for personal services covers all amounts paid currently or accrued by the institution for services of employees rendered during the period of performance under sponsored agreements. Such amounts include salaries, wages, and fringe benefits (See Section J15.). These costs are allowable to the extent that the total compensation to individual employees conforms to the established policies of the institution, consistently applied, and provided that the charges for work performed directly on sponsored agreements and for other work allocable as indirect costs are determined and supported as provided below. Charges to sponsored agreements may include reasonable amounts for activities contributing and intimately related to work under the agreements, such as delivering special lectures about specific aspects of the ongoing activity, writing reports and articles, participating in appropriate seminars, consulting with colleagues and graduate students, and attending meetings and conferences. Incidental work (that in excess of normal for the individual), for which supplemental compensation is paid by an institution under institutional policy, need not be included in the payroll distribution systems described below, provided such work and compensation are separately identified and documented in the financial management system of the institution.

b. *Payroll distribution.* For each organizational unit of an institution, the distribution of salaries and wages of professorial or professional staff (whether charged direct or required to be distributed to more than one activity for purposes of allocating indirect costs) will be based on either a system of monitored workload or a system of personnel activity reports. The latter system will be used for nonprofessional employees whose costs are charged direct or are required to be distributed to more than one activity for purposes of allocating indirect costs. In the use of either method, it is recognized that, because of the nature of work involved in academic institutions, the various and often interrelated activities of professorial and professional employees frequently cannot be measured with a high degree of precision, that reliance must be placed on reasonably accurate approximations, and that acceptance of a degree of tolerance in measurement is appropriate.

c. *Monitored workload.* Under this method the distribution of salaries and wages applicable to sponsored agreements is based on budgeted or assigned workload, updated to reflect any significant changes in workload distributions. A monitored workload system used for salaries and wages charged directly or indirectly to sponsored agreements will meet the following standards:

(1) A system of budgeted or assigned workload will be incorporated into the official records of the institution and encompass both sponsored and all other activities on an integrated basis. The system may include the use of subsidiary records.

(2) The system will reasonably reflect workload of employees, accounting for 100 percent of the work for which the employee is compensated and which is required in fulfillment of the employee's obligations to the institution. Because practices vary among institutions and within institutions as to the total activity constituting a full workload—when expressed in measurable units, such as contact hours in teaching—the system will be based on a determination for each individual, reflecting the ratio of each of the activities which comprise the total workload of the individual. (But see Section H for treatment of indirect costs under the simplified method for small institutions.)

(3) The system will provide for modification of an individual's salary or salary distribution commensurate with any significant change in the employee's workload or the ratio of activities comprising the total workload. A significant change in an employee's workload shall be considered to include the following as a minimum: when work begins or ends on a sponsored agreement, when a teaching load is materially modified, when additional unanticipated assignments are received or taken away, when an individual begins or ends a sabbatical leave, prolonged sick leave, or leave without pay, etc. Short-term (such as one or two months) fluctuation between workload categories need not be considered as long as the distribution of salaries and wages is reasonable over the longer term such as an academic period. Whenever it is apparent that a change in workload will occur or has occurred, the change will be documented over the signature of a responsible official and, if significant, entered into the system.

(4) The system will utilize workload categories reflecting activity which is applicable to each sponsored agreement, each indirect cost activity, and each major function of the institution.

(5) At least annually a statement will be signed by the employee, principal investigator, or responsible official, having first hand knowledge of the work stating that salaries and wages charged to sponsored agreements as direct charges, or that salaries and wages charged to both direct and indirect cost categories, or to more than one indirect cost category are reasonable.

(6) The system will provide for independent internal evaluations to insure that it is working effectively.

(7) In the use of this method an institution shall not be required to provide additional support or documentation for the effort actually performed, but is responsible for assuring that the system meets the above standards.

d. *Personnel activity reports.* Under this system the distribution of salaries and wages will be supported by personnel activity reports as prescribed below.

(1) Personnel activity reports will reflect the distribution of activity expended by each employee covered by the system.

(2) The reports will reflect an after-the-fact reporting of the percentage of activity of each employee. Charges may be made initially on the basis of estimates made before the services are performed, provided that such charges are promptly adjusted if significant differences are indicated by activity reports.

(3) Each report will account for 100 percent of the activity for which the employee is compensated and which is required in fulfillment of the employee's obligations to the institution. The report will reasonable reflect the percentage of activity applicable to each sponsored agreement, each indirect cost category, and each major function of the institution.

(4) To confirm that the distribution of activity represents a reasonable estimate of the work performed by the employee during the period, each report will be signed by the employee or by a responsible official having first hand knowledge of the work performed.

(5) For professorial and professional staff, the reports will be prepared each academic term, but no less frequently than every six months. For other individuals, the reports will be prepared no less frequently than monthly and will coincide with one or more pay periods.

(6) Where the institution uses time cards or other forms of after-the-fact payroll documents as original documentation for payroll and payroll charges, such documents shall qualify as a personnel activity report provided that they are meet the requirements in (1) through (5) above.

e. *Salary rates for faculty members.*

(1) *Salary rates for academic year.* Charges for work performed on sponsored agreements by faculty members during the academic year will be based on the individual faculty member's regular compensation for the continuous period which, under the policy of the institution concerned, constitutes the basis of his salary. Charges for work performed on sponsored agreements during all or any portion of such period are allowable at the base salary rate. In no event will charges to sponsored agreements, irrespective of the basis of computation, exceed the proportionate share of the base salary for that period. This principle applies to all members of the faculty at an institution. Since intra-university consulting is assumed to be undertaken as a university obligation requiring no compensation in addition to full-time base salary, the principle also applies to faculty members who function as consultants or otherwise contribute to a sponsored agreement conducted by another faculty member of the same institution. However, in unusual cases where consultation is across departmental lines or involves a separate or remote operation, and the work performed by the consultant is in addition to his regular departmental load, any charges for such work representing extra compensation above the base salary are allowable provided that such consulting arrangements are specifically provided for in the agreement or approved in writing by the sponsoring agency.

(2) *Periods outside the acadmeic year.*

(a) Except as otherwise specified for teaching activity in (b) below, charges for work performed by faculty members on sponsored agreements during the summer months or other period not included in the base salary period will be determined for each faculty member at a rate not in excess of the base salary divided by the period to which the base salary relates, and will be limited to charges made in accordance with other parts of this section. The base salary period used in computing charges for work performed during the summer months will be the number of months covered by the faculty member's official academic year appointment.

(b) Charges for teaching activities performed by faculty members on sponsored agreements during the summer months or other periods not included in the base salary period will be based on the normal policy of the institution governing compensation to faculty members for teaching assignments during such periods.

(3) *Part-time faculty.* Charges for work performed on sponsored agreements by faculty members having only part-time appointments will be determined at a rate not in excess of that regularly paid for the part-time assignments; e.g., an institution pays $5,000 to a faculty member for half-time teaching during the academic year. He devoted one-half of his remaining time to a sponsored agreement. Thus, his additional compensation, chargeable by the institution to the agreement, would be one-half of $5,000, or $2,500.

f. *Noninstitutional professional activities.* Unless an arrangement is specifically authorized by a Federal sponsoring agency, an institution must follow its institution-wide policies and practices concerning the permissible extent of professional services that can be provided outside the institution for noninstitutional compensation. Where such institution-wide policies do not exist or do not adequately define the permissible extent of consulting or other noninstitutional activities undertaken for extra outside pay, the Government may require that the effort of professional staff working on sponsored agreements be allocated between (1) institutional activities, and (2) noninstitutional professional activities. If the sponsoring agency considers the extent of noninstitutional professional effort excessive, appropriate arrangements governing compensation will be negotiated on a case-by-case basis.

7. *Contingency provisions.* Contributions to a contingency reserve or any similar provision made for events, the occurrence of which cannot be foretold with certainty as to time, intensity, or with an assurance of their happening, are unallowable. (But see also Section J16c.)

8. *Deans of faculty and graduate schools.* The salaries and expenses of deans of faculty and graduate schools, or their equivalents, and their staffs, are allowable.

9. *Depreciation and use allowances.* Institutions may be compensated for the use of their buildings, capital improvements, and equipment; provided that they are used, needed in the institutions' activities, and properly allocable to sponsored agreements. Such compensation shall be made by computing either depreciation or use allowance. Use allowances are the means of providing such compensation when depreciation or other equivalent costs are not computed. The allocation for depreciation or use allowance shall be made in accordance with Section F1. Depreciation and use allowances are computed applying the following rules:

a. The computation of depreciation or use allowances shall be based on the acquisition cost of the assets involved. For this purpose, the acquisition cost will exclude (1) the cost of land; (2) any portion of the cost of buildings and equipment borne by or donated by the Government, irrespective of where title was originally vested of where it is presently located; and (3) any portion of the cost of buildings and equipment contributed by or for the institution where law or agreement prohibit recovery. For an asset donated to the institution by a third party, its fair market value at the time of the donation shall be considered as the acquisition cost.

b. In the use of the depreciation method, the following shall be observed:

(1) The period of useful service or useful life established in each case for usable capital assets must take into consideration such factors as type of construction, nature of the equipment, technological developments in the particular area, and the renewal and replacement policies followed for the individual items or classes of assets involved.

(2) The depreciation method used to charge the cost of an asset (or group of assets) to accounting periods shall reflect the pattern of consumption of the asset during its useful life. In the absence of clear evidence indicating that the expected consumption of the asset will be significantly greater in the early portions than in the later portions of its useful life, the straight-line method shall be presumed to be the appropriate method. Depreciation methods once used shall not be changed unless approved in advance by the cognizant Federal agency.

(3) Where the depreciation method is introduced for application to assets for which use allowance was previously charged, the aggregate amount of use allowances and depreciation applicable to such assets must not exceed the total acquisition cost of the assets.

(4) When the depreciation method is used for buildings, a building "shell" may be treated separately from other building components, such as plumbing system and heating and air conditioning system. Each component item may then be depreciated over its estimated useful life. On the other hand, the entire building, including the shell and all components, may be treated as a single asset and depreciated over a single useful life.

(5) Where the depreciation method is used for a particular class of assets, no depreciation may be allowed on any such assets that have outlived their depreciable lives. (But see also c(3), below.)

c. Under the use allowance method, the following shall be observed:

(1) The use allowance for buildigs and improvements (including improvements such as paved parking areas, fences, and sidewalks) will be computed at an annual rate not exceeding two percent of acquisition cost. The use allowance for equipment will be computed at an annual rate not exceeding six and two-thirds percent of acquisition cost.

(2) In contrast to the depreciation method, the entire building must be treated as a single asset without separating its "shell" from other building components under the use allowance method. The entire building must be treated as a single asset, and the two-percent use allowance limitation must be applied to all parts of the building. The two-percent limitation, however, need not be applied to equipment or other assets that are merely attached or fastened to the building but not permanently fixed and are used as furnishings, decorations or for specialized purposes (e.g., dentist chairs and dental treatment units, counters, laboratory benches bolted to the floor, dishwashers, and carpeting). Such equipment and assets will be considered as not being permanently fixed to the building if they can be removed without the need for costly or extensive alterations or repairs to the building to make the space usable for other purposes. Equipment and assets which meet these criteria will be subject to the six and two-thirds percent equipment use allowance.

(3) A reasonable use allowance may be negotiated for any assets that are considered to be fully depreciated, after taking into consideration the amount of depreciation previously charged to the Government, the estimated useful life remaining at the time of negotiation, the effect of any increased maintenance charges, decreased efficiency due to age, and any othe factors pertinent to the utilization of the asset for the purpose contemplated.

d. Except as otherwise provided in b and c above, a combination of the depreciation and use allowance methods may not be used, in like circumstances, for a single class of assets (e.g., buildings, office equipmet, and computer equipment).

e. Charges for use allowances or depreciation must be supported by adequate property records, and physical inventories must be taken at least once every two years to ensure that the assets exist and are usable, used, and needed. Statistical sampling techniques may be used in taking these inventories. In addition, when the depreciation method is used, adequate depreciation records showing the amount of depreciation taken each period must also be maintained.

10. *Donated services and property.* The value of donated services and property are not allowable either as a direct or indirect cost, except that depreciation or use allowances on donated assets are permitted in accordance with Section J9a. The value of donated services and property may be used to meet cost sharing or matching requirements, in accordance with OMB Circular No. A-110.

11. *Employee morale, health, and welfare costs and credits.* The costs of house publications, health or first-aid clinics and/or infirmaries, recreational activities, employees, counseling services, and other expenses incurred in accordance with the institution's established practice or custom for the improvement of working conditions, employer-employee relations, employee morale, and employee performance, are allowable. Income generated from any of these activities will be credited to the cost thereof unless such income has been irrevocably set over to employee welfare organizations.

12. *Entertainment costs.* Costs incurred for amusment, social activities, entertainment, and any items relating thereto, such as meals, lodging, rentals, transportation, and gratuities, are unallowable.

13. *Equipment and other capital expenditures.*

a. For purposes of this paragraph, the following definitions apply:

(1) *Equipment* means an article of nonexpendable tangible personal property having a useful life or more than two years, and an acquisition cost of $500 or more per unit. However, consistent with institutional policy, lower limits may be established.

(2) *Capital expenditure* means the cost of the asset including the cost to put it in place. Capital expenditure for equipment, for example, means the net invoice price of the equipment, including the cost of any modifications, attachments, accessories, or auxiliary apparatus necessary to make it usable for the purpose for which it is acquired. Ancillary charges, such as taxes, duty, protective intransit insurance, freight, and installation may be included in, or excluded from, capital expenditure cost in accordance with the institution's regular accounting practices.

(3) *Special purpose equipment* means equipment which is used only for research, medical, scientific, or other technical activities.

(4) *General purpose equipment* means equipment, the use of which is not limited only to research, medical, scientific or other technical activities. Examples of general purpose equipment include office equipment and furnishings, air conditioning equipment, reproduction and printing equipment, motor vehicles, and automatic data processing equipment.

b. The following rules of allowability shall apply to equipment and other capital expenditures:

(1) Capital expenditures for general purpose equipment, buildings, and the land are unallowable as direct charges, except where approved in advance by the sponsoring agency.

(2) Capital expenditures for special purpose equipment are allowable as direct charges, provided that the acquisition of items having a unit cost of $1,000 or more is approved in advance by the sponsoring agency.

(3) Capital expenditures for improvements to land, buildings, or equipment which materially increase their value or useful life are unallowable as direct charges, except where approved in advance by the sponsoring agency.

(4) Capital expenditures are unallowable as indirect costs. But see Section J9 for allowability of depreciation or use allowance on buildings, capital improvements, and equipment. Also see Section J33 for allowability of rental costs on land, buildings, and equipment.

14. *Fines and penalties.* Costs resulting from violations of, or failure of the institution to comply with, Federal, State, and local laws and regulations are unallowable, except when incurred as a result of compliance with specific provisions of the sponsored agreement, or instructions in writing from the contracting officer or equivalent.

15. *Fringe benefits.*

a. Fringe benefits in the form of regular compensation paid to employees during periods of authorized absences from the job, such as for annual leave, sick leave, military leave, and the like, are allowable, provided such costs are distributed to all institutional activities in proportion to the relative amount of time or effort actually devoted by the employees. See Section J35 for treatment of sabbatical leave.

b. Fringe benefits in the form of employer contributions or expenses for social security, employee insurance, workmen's compensation insurance, tuition or remission of tuition for individual employees or their families and the like are allowable, provided such benefits are granted in accordance with established institutional policies, and are distributed to all institutional activities on an equitable basis. See Section J36b for treatment of tuition remission provided to students.

c. Rules for pension plan costs are as follows:

(1) Costs of the institution's pension plan which are incurred in accordance with the established policies of the institution are allowable, provided (a) such policies meet the test of reasonableness; (b) the methods of cost allocation are equitable for all activities; (c) the amount of pension cost assigned to each fiscal year is determined in accordance with (2) below; and (d) the cost assigned to a given fiscal year is paid or funded for all plan participants within six months after the end of that year.

(2) The amount of pension cost assigned to each fiscal year shall be determined in accordance with generally accepted accounting principles. Institutions may elect to follow the "Cost Accounting Standard for Composition and Measurement of Pension Cost" (4 CFR Part 412).

(3) Premiums paid for pension plan termination insurance pursuant to the Employee Retirement Income Security Act of 1974 (Public Law 93-406) are allowable. Late payment charges on such premiums are unallowable. Excise taxes on accumulated funding deficiencies and prohibited transactions of pension plan fiduciaries imposed under the Employee Retirement Income Security Act are also unallowable.

d. Fringe benefit may be assigned to cost objectives by identifying specific benefits to specific individual employees or by allocating on the basis of the salaries and wages of the employees receiving the benefits. When the allocation method is used, separate allocations must be made to selective groupings of employees, if the costs in relationship to salaries and wages differ significantly for different groups of employees. Also fringe benefits related to institutional salaries and wages treated as direct costs may be treated as direct costs.

16. *Insurance and indemnification.*

a. Costs of insurance required or approved, and maintained, pursuant to the sponsored agreement, are allowable.

b. Costs of other insurance maintained by the institution in connection with the general conduct of its activities, are allowable subject to the following limitations: (1) types and extent and cost of coverage must be in accordance with sound institutional practice; (2) costs of insurance or of any contributions to any reserve covering the risk of loss of or damage to Government-owned property are unallowable, except to the extent that the Government has specifically required or approved such costs; and (3) costs of insurance on the lives of officers or trustees are unallowable except where such insurance is part of an employee plan which is not unduly restricted.

c. Contributions to a reserve for a self-insurance program are allowable, to the extent that the types of coverage, extent of coverage, and the rates and premiums would have been allowed had insurance been purchased to cover the risks.

d. Actual losses which could have been covered by permissible insurance (whether through purchased incurance or self-insurance) are unallowable, unless expressly provided for in the sponsored agreement, except that costs incurred because of losses not covered under existing deductible clauses for insurance coverage provided in keeping with sound management practice as well as minor losses not covered by insurance, such as spoilage, breakage and disappearance of small hand tools, which occur in the ordinary course of operations, are allowable.

e. Indemnification includes securing the institution against liabilities to third persons and other losses not compensated by insurance or otherwise. The Government is obligated to indemnify the institution only to the extent expressly provided for in the sponsored agreement, except as provided in d above.

17. *Interest, fund raising, and investment management costs.*

a. Costs incurred for interest on borrowed capital or temporary use of endowment funds, however represented, are unallowable.

b. Costs of organized fund raising, including financial campaigns, endowment drives, solicitation of gifts and bequests, and similar expenses incurred solely to raise capital or obtain contributions, are unallowable.

c. Costs of investment counsel and staff and similar expenses incurred solely to enhance income from investments are unallowable.

d. Costs related to the physical custody and control of monies and securities are allowable.

18. *Labor relations costs.* Costs incurred in maintaining satisfactory relations between the institution and its employees, including costs of labor management committees, employees' publications, and other related activities, are allowable.

19. *Losses on other sponsered agreements or contracts.* Any excess of costs over income under any other sponsored agreement or contract of any nature is unallowable. This includes, but is not limited to, the institution's contributed portion by reason of cost-sharing agreements or any under-recoveries through negotiation of flat amounts for indirect costs.

20. *Maintenance and repair costs.* Costs incurred for necessary maintenance, repair or upkeep of property (including Government property unless otherwise provided for) which neither add to the permanent value of the property nor appreciably prolong its intended life but keep it in an efficient operating condition, are allowable.

21. *Material costs.* Costs incurred for purchased materials, supplies, and fabricated parts directly or indirectly related to the sponsored agreement, are allowable. Purchases made specifically for the sponsored agreement should be charged thereto at their actual prices after deducting all cash discounts, trade discounts, rebates, and allowances received by the institution. Withdrawals from general stores or stockrooms should be charged at their cost under any recognized method of pricing stores withdrawals conforming to sound accounting practices consistently followed by the institution. Incoming transportation charges are a proper part of material cost. Direct material cost should include only the materials and supplies actually used for the performance of the sponsored agreement, and due credit should be given for any excess materials retained, or returned to vendors. Due credit should be given for all proceeds or value received for any scrap resulting from work under the sponsored agreement. Where Government-donated or furnished material is used in performing the sponsored agreement, such material will be used without charge.

22. *Memberships, subscriptions and professional activity costs.*

a. Costs of the institution's membership in civic, business, technical, and professional organizations are allowable.

b. Costs of the institution's subscriptions to civic, business, professional, and technical periodicals are allowable.

c. Costs of meetings and conferences, when the primary purpose is the dissemination of technical information, are allowable. This includes costs of meals, transportation, rental of facilities, and other items incidental to such meetings or conferences.

23. *Patent costs.* Costs of preparing disclosures, reports, and other documents required by the sponsored agreement, and of

searching the art to the extent necessary to make such invention disclosures, are allowable. In accordance with the clauses of the sponsored agreement relating to patents, costs of preparing documents and any other patent costs, in connection with the filing of a patent application where title is conveyed to the Government, are allowable. (See also Section J34.)

24. *Plant security costs.* Necessary expenses incurred to comply with security requirements, including wages, uniforms and equipment of personnel engaged in plant protection, are allowable.

25. *Preagreement costs.* Costs incurred prior to the effective date of the sponsored agreement, whether or not they would have been allowable thereunder if incurred after such date, are unallowable unless approved by the sponsoring agency.

26. *Professional services costs.*

a. Costs of professional services rendered by the members of a particular profession who are not employees of the institution are allowable, subject to b and c below, when reasonable in relation to the services rendered and when not contingent upon recovery of the costs from the Government. Retainer fees to be allowable must be reasonably supported by evidence of services rendered.

b. Factors to be considered in determining the allowability of costs in a particular case include (1) the past pattern of such costs, particularly in the years prior to the award of sponsored agreements; (2) the impact of sponsored agreements on the institution's total activity; (3) the nature and scope of managerial services expected of the institution's own organizations; and (4) whether the proportion of Government work to the institution's total activity is such as to influence the institution in favor of incurring the cost, particularly where the services rendered are not of a continuing nature and have little relationship to work under sponsored agreements.

c. Costs of legal, accounting, and consulting services, and related costs, incurred in connection with the prosecution of claims against the Government, are unallowable. Costs of legal, accounting and consulting services, and related costs, incurred in connection with patent infringement litigation, are unallowable unless otherwise provided for in the sponsored agreements.

27. *Profits and losses on disposition of plant equipment or other capital assets.* Profits or losses arising from the sale or exchange of plant, facilities, equipment or other capital assets, including sale or exchange of either short-term or long-term investments, shall not be considered in computing the costs of sponsored agreements except for pension plans as provided in Section J15c. When assets acquired with Federal funds, in part or wholly, are disposed of, the distribution of the proceeds shall be made in accordance with Attachment N, OMB Circular No. A-110.

28. *Proposal costs.* Proposal costs are the costs of preparing bids or proposals on potential Government and nongovernment sponsored agreements or projects, including the development of data necessary to support the institution's bids or proposals. Proposal costs of the current accounting period of both successful and unsuccessful bids and proposals normally should be treated as indirect costs and allocated currently to all activities of the institution, and no proposal costs of past accounting periods will be allocable to the current period. However, the institution's established practices may be to treat proposal costs by some other recognized method. Regardless of the method used, the results obtained may be accepted only if found to be reasonable and equitable.

29. *Public information services costs.* Cost of news releases pertaining to specific research or scientific accomplishment are allowable, when they result from performance of sponsored agreements.

30. *Rearrangement and alteration costs.* Cost incurred for ordinary or normal rearrangement and alteration of facilities are allowable. Special arrangement and alteration costs incurred specifically for the project are allowable when such work has been approved in advance by the sponsoring agency.

31. *Reconversion costs.* Costs incurred in the restoration or rehabilitation of the institution's facilities to approximately the same condition existing immediately prior to commencement of a sponsored agreement, fair wear and tear excepted, are allowable.

32. *Recruiting costs.*

a. Subject to b, c, and d below, and provided that the size of the staff recruited and maintained is in keeping with workload requirements, costs of "help wanted" advertising, operating costs of an employment office necessary to secure and maintain an adequate staff, costs of operating an aptitude and educational testing program, travel costs of employees while engaged in recruiting personnel, travel costs of applicants for interviews for prospective employment, and relocation costs incurred incident to recruitment of new employees, are allowable to the extent that such costs are incurred pursuant to a well managed recruitment program. Where the institution uses employment agencies, costs not in excess of standard commercial rates for such services are allowable.

b. In publications, costs of help wanted advertising that includes color, includes advertising material for other than recruitment purposes, or is excessive in size (taking into consideration recruitment purposes for which intended and normal institutional practices in this respect), are unallowable.

c. Costs of help wanted advertising, special emoluments, fringe benefits, and salary allowances incurred to attract professional personnel from other institutions that do not meet the test of reasonableness or do not conform with the established practices of the institution, are unallowable.

d. Where relocation costs incurred incident to recruitment of a new employee have been allowed either as an allocable direct or indirect cost, and the newly hired employee resigns for reasons within his control within twelve months after hire, the institution will be required to refund or credit such relocation costs to the Government.

33. *Rental cost of buildings and equipment.*

a. Rental costs of buildings or equipment are allowable to the extent that the decision to rent or lease is in accord with Section C-3. Rental arrangements should be reviewed periodically to determine if circumstances have changed and other options are available.

b. Rental costs under "sale and lease back" arrangements are allowable only up to the amount that would be allowed if the institution continued to own the property.

c. Rental costs under "less-than-arms-length" leases are allowable only up to the amount that would be allowed if the institution owned the property. For this purpose, a "less-than-arms-length" lease is one under which one party to the lease agreement is able to control or substantially influence the actions of the other.

d. Where significant rental costs are incurred under leases which create a material equity in the leased property, they are allowable only up to the amount that would be allowed if the institution purchased the property on the date the lease agreement was executed. For this purpose, a material equity in the property exists when the lease:

(1) is noncancelable or is cancelable only upon the occurrence of some remote contingency, and

(2) has one or more of the following characteristics:

(a) Title to the property passes to the institution at some time during or after the lease period.

(b) The term of the lease corresponds substantially to the estimated useful life of the property (i.e., the period of economic usefulness to the legal owner of the property).

(c) The initial term is less than the useful life of the property and the institution has the option to renew the lease for the remaining useful life at substantially less than fair rental value.

(d) The property was acquired by the leasor to meet the special needs of the institution and will probably be usuable only for that purpose and only by the institution.

(e) The institution has the right, during or at the expiration of the lease, to purchase the property at a price which at the inception of the lease appears to be substantially less that the probable fair market value at the time it is permitted to purchase the property (commonly called a lease with a bargain purchase option), except for any discount normally given to educational institutions.

34. *Royalties and other costs for use of patents.* Royalties on a patent or amortization of the cost of acquiring a patent or invention or rights thereto, necessary for the proper performance of the sponsored agreement and applicable to tasks or processes thereunder, are allowable unless the Government has a license or the right to free use of the patent, the patent has been adjudicated to be invalid or has been administratively determined to be invalid, the patent is considered to be unenforceable, or the patent has expired.

35. *Sabbatical leave costs.* Costs of leave of absence by employees for performance of graduate work or sabbatical study, travel, or research are allowable provided the institution has a uniform policy on sabbatical leave for persons engagd in instruction and persons engaged in research. Such costs will be allocated on an equitable basis among all related activities of the institution. Where sabbatical leave is included in fringe benefits for which a cost is determined for assessment as a direct charge, the aggregate amount of such assessments applicable to all work of the institution during the base period must be reasonable in relation to the institution's actual experience under its sabbatical leave policy.

36. *Scholarships and student aid costs.*

a. Costs of scholarships, fellowships, and other programs of student aid are allowable only when the purpose of the sponsored agreement is to provide training to selected participants and the charge is approved by the sponsoring agency. However, tuition re-

mission and other forms of compensation paid as, or in lieu of, wages to students performing necessary work are allowable provided that (1) there is a bonafide employer-employee relationship between the student and the institution for the work performed, (2) the tuition or other payments are reasonable compensation for the work performed and are conditioned explicitly upon the performance of necessary work, and (3) it is the institution's practice to similarly compensate students in nonsponsored as well as sponsored activities.

b. Charges for tuition remission and other forms of compensation paid to students as, or in lieu of, salaries and wages shall be subject to the reporting requirements stipulated in Section J6, and shall be treated as direct or indirect cost in accordance with the actual work being performed. Tuition remission may be charged on an average rate basis.

37. *Severance pay.*

a. Severance pay is compensation in addition to regular salary and wages which is paid by an institution to employees whose services are being terminated. Costs of severance pay are allowable only to the extent that such payments are required by law, by employer-employee agreement, by established policy that constitutes in effect an implied agreement on the institution's part, or by circumstances of the particular employment.

b. Severance payments that are due to normal recurring turnover and which otherwise meet the conditions of a above may be allowed provided the actual costs of such severance payments are regarded as expenses applicable to the current fiscal year and are equitably distributed among the institution's activities during that period.

c. Severance payments that are due to abnormal or mass terminations are of such conjectural nature that allowability must be determined on a case-by-case basis. However, the Government recognizes its obligation to participate, to the extent of its fair share, in any specific payment.

38. *Specialized service facilities.*

a. The costs of institutional services involving the use of highly complex or specialized facilities such as electronic computers, wind tunnels, and reactors are allowable, provided the charge for the service meets the conditions of b through d below.

b. The cost of each service normally shall consist of both its direct costs and its allocable share of indirect costs with deductions for appropriate income or Federal financing as describing in Section C5.

c. The cost of such institutional services when material in amount will be charged directly to users, including sponsored agreements based on actual use of the services and a schedule of rates that does not discriminate between federally and nonfederally supported activities of the institution, including used by the institution for internal purposes. Charges for the use of specialized facilities should be designed to recover not more than the aggregate cost of the services over a long-term period agreed to by the institution and the cognizant Federal agency. Accordingly, it is not necessary that the rates charged for services be equal to the cost of providing those services during any one fiscal year as long as rates are reviewed periodically for consistency with the long-term plan and adjusted if necessary.

d. Where the costs incurred for such institutional services are not material, they may be allocated as indirect costs. Such arrangements must be agreed to by the institution and the cognizant Federal agency.

e. Where it is in the best interest of the Government and the institution to establish alternative costing arrangements, such arrangements may be worked out with the cognizant Federal agency.

39. *Special services costs.* Costs incurred for general public relations activities, alumni activities, and similar services, are unallowable.

40. *Student activity costs.* Costs incurred for intramural activities, student publications, student clubs, and other student activities, are unallowable, unless specifically provided for in the sponsored agreements.

41. *Taxes.*

a. In general, taxes which the institution is required to pay and which are paid or accrued in accordance with generally accepted accounting principles are allowable. Payments made to local governments in lieu of taxes which are commensurate with the local government services received are allowable, except for (1) taxes from which exemptions are available to the institution directly or which are available to the institution based on an exemption afforded the Government, and in the latter case when the sponsoring agency makes available the necessary exemption certificates; and (2) special assesssments on land which represent capital improvements.

b. Any refund of taxes, interest, or penalties, and any payment to the institution of interest thereon, attributable to taxes, interest, or penalties which were allowed as sponsored agreement costs, will be credited or paid to the Government in the manner directed by the Government. However, any interest actually paid or credited to an institution incident to a refund of tax, interest, and penalty will be paid or credited to the Government only to the extent that such interest accrued over the period during which the institution had been reimbursed by the Government for the taxes, interest, and penalties.

42. *Transportation costs.* Costs incurred for freight, express, cartage, postage, and other transportation services relating either to goods purchased, in process, or delivered, are allowable. When such costs can readily be identified with the items involved, they may be charged directly as transportation costs or added to the cost of such items. Where identification with the materials received cannot readily be made, inbound transportation costs may be charged to the appropriate indirect cost accounts if the institution follows a consistent, equitable procedure in this respect. Outbound freight, if reimbursable under the terms of the sponsored agreement, should be treated as a direct cost.

43. *Travel costs.*

a. Travel costs are the expenses for transportation, lodging, subsistence, and related items incurred by employees who are in travel status on official business of the institution. Such costs may be charged on an actual basis, on a per diem or mileage basis in lieu of actual costs incurred, or on a combination of the two, provided the method used is applied to an entire trip and not to selected days of the trip, and results in charges consistent with those normally allowed by the institution in its regular operations.

b. Travel costs are allowable subject to c, d, e, and f below, when they are directly attributable to specific work under a sponsored agreement or are incurred in the normal course of administration of the institution or a department or program thereof.

c. The difference in cost between first-class air accommodations and less than first-class air accommodations is unallowable except when less than first-class air accommodations are not reasonably available to meet necessary mission requirements, such as where less than first-class accommodations would (1) require circuitous routing, (2) require travel during unreasonable hours, (3) greatly increase the duration of the flight, (4) result in additional costs which would offset the transportation savings, or (5) offer accommodations which are not reasonably adequate for the medical needs of the traveler.

d. Costs of personnel movements of a special or mass nature are allowable only when authorized or approved in writing by the sponsoring agency or its authorized representative.

e. Foreign travel costs are allowable only when the travel has received specific prior approval. Each separate foreign trip must be specifically approved. For purposes of this provision, foreign travel is defined as any travel outside of Canada and the United States and its territories and possessions. However, for an organization located outside Canada and the United States and its territories and possessions, foreign travel means travel outside that country.

f. Domestic travel costs are allowable when permitted by the sponsored agreement. Expenditures for such travel will not be allowed if they exceed the amount specified by more than 25% or $500, whichever is greater, except with an advanced approval of the sponsoring agency.

44. *Termination costs applicable to sponsored agreements.*

a. Termination of sponsored agreements generally gives rise to the incurrence of costs or to the need for special treatment of costs, which would not have arisen had the agreement not been terminated. Items peculiar to termination are set forth below. They are to be used in conjunction with all other provisions of this Circular in the case of termination.

b. The cost of common items of material reasonably usable on the institution's other work will not be allowable unless the institution submits evidence that it could not retain such items at cost without sustaining a loss. In deciding whether such items are reasonably usable on other work of the institution, consideration should be given to the institution's plans and orders for current and scheduled work. Contemporaneous purchases of common items by the institution will be regarded as evidence that such items are reasonably usable on the institution's other work. Any acceptance of common items as allowable to the terminated portion of the agreement should be limited to the extent that the quantities of such items on hand, in transit, and on order are in excess of the reasonable quantitative requirements of other work.

c. If in a particular case, despite all reasonable efforts by the institution, certain costs cannot be discontinued immediately after the effective date of termination, such costs are generally allowable within the limitations set forth in this Circular, except that any such costs continuing after termination due to the negligent or willful failure

of the institution to discontinue such costs will be considered unacceptable.

d. Loss of useful value of special tooling, and special machinery and equipment is generally allowable, provided (1) such special tooling, machinery, or equipment is not reasonably capable of use in the other work of the institution; (2) the interest of the Government is protected by transfer of title or by other means deemed appropriate by the contracting officer or equivalent; and (3) the loss of useful value as to any one terminated agreement is limited to that portion of the acquisition cost which bears the same ratio to the total acquisition cost as the terminated portion of the agreement bears to the entire terminated agreement and other Government agreements for which the special tooling, special machinery, or equipment was acquired.

e. Rental costs under unexpired leases are generally allowable where clearly shown to have been reasonably necessary for the performance of the terminated agreement, less the residual value of such leases, if (1) the amount of such rental claimed does not exceed the reasonable use value of the property leased for the period of the agreement and such further period as may be reasonable; and (2) the institution makes all reasonable efforts to terminate, assign, settle, or otherwise reduce the cost of such lease. There also may be included the cost of alterations of such leased property, provided such alterations were necessary for the performance of the agreement, and of reasonable restoration required by the provisions of the lease.

f. Settlement expenses including the following are generally allowable: (1) accounting, legal, clerical, and similar costs reasonably necessary for the preparation and presentation to contracting officers or equivalent of settlement claims and supporting data with respect to the terminated portion of the agreement, and the termination and settlement of subagreements; and (2) reasonable costs for the storage, transportation, protection, and disposition of property provided by the Government or acquired or produced by the institution for the agreement, except when the institution is reimbursed for disposals at a predetermined amount in accordance with the provisions of Circular No. A-110.

g. Claims under subagreements, including the allocable portion of claims which are common to the agreement and to other work of the institution, are generally allowable.

K. CERTIFICATION OF CHARGES

To assure that expenditures for sponsored agreements are proper and in accordance with the agreement documents and approved project budgets, the annual and/or final fiscal reports or vouchers requesting payment under the agreements will include a certification, signed by an authorized official of the university, which reads essentially as follows: "I certify that all expenditures reported (or payment requested) are for appropriate purposes and in accordance with the provisions of the application and award documents."

[FR Doc. 79-6448 Filed 3-5-79; 8:45 am]

federal register

Tuesday
August 3, 1982

Part IV

Office of Management and Budget

Circular A-21; Cost Principles for Educational Institutions

Circular No. A-21, Revise. Transmittal Memorandum No. 1

July 23, 1982.

To: The Heads of Executive Departments and Establishments.

Subject: Cost principles for universities.

This Transmittal Memorandum revises OMB Circular No. A-21, "Cost principles for educational institutions."

The revision cha nges the procedures covering allocation of personal service costs and recognizes interest costs in certain circumstances.

David A. Stockman,

Director.

Circular A-21—Cost Principles for Educational Institutions

Circular A-21 is revised as follows:

Paragraph B.1.

The following replalces section B.1:

B. *Definition of Terms.*

1. *Major functions of an institution* refers to instruction, organized research, other sponsored activities, and other institutional activities as defined below:

a. *Instruction* means the teaching and training activities of an institution. Except for research training as provided in c. below, this term includes all teaching and training activities, whether they are offered for credits toward a degree or certificate or on a non-credit basis, and whether they are offered through regular academic departments or separate divisions, such as a summer school division or an extension division. Also considered part of this major function are departmental research, and, where agreed to, university research.

(1) *Sponsored instruction and training* means specific instructional or training activity established by grant, contract, or cooperative agreement. For purposes of the cost principles, this activity may be considered a major function even though an institution's accounting treatment may include it in the instruction function.

(2) *Departmental research* means research development and scholarly activities that are not organized research and, consequently, are not separately budgeted and accounted for. Departmental research, for purposes of this document, is not considered as a major function, but as a part of the instruction function of the institution.

b. *Organized research* means all research and development activities of an institution that are separately budgeted and accounted for. It includes:

(1) *Sponsored research* means all research and development activities that are sponsored by Federal and non-Federal agencies and organizations. This term includes activities involving the training of individuals in research techniques (commonly called research training) where such activities utilize the same facilities as other research and development activities and where such activities are not included in the instruction function.

(2) *University research* means all research and development activities that are separately budgeted by the institution under an internal application of institutional funds. University research, for purposes of this document, may be considered a part of the instruction function, or may be combined with sponsored research under the function, of organized research, or may be treated as a separate major function, as agreed to with the cognizant agency.

c. d. becomes c.

d. e. becomes d.

Paragraph J.6.

The following replaces sections J.6. b. through d.

J. *Compensation for Personal Services.*

6.b.(1) *General Principles.* (a) The distribution of salaries and wages whether treated as direct or indirect costs, will be based on payrolls documented in accordance with the generally accepted practices of colleges and universities. Institutions may include in a residual category all activities that are not directly charged to sponsored agreements, and that need not be distributed to more than one activity for purposes of identifying indirect costs and the functions to which they are allocable. The components of the residual category are not required to be separately documented.

(b) The apportionment of employee's salaries and wages which are chargeable to more than one sponsored agreement or other cost objective will be accomplished by methods which will (1) be in accordance with Sections A-2 and C above, (2) produce an equitable distribution of charges for employee's activities, and (3) distinguish the employees' direct activities from their indirect activities.

(c) In the use of any methods for apportioning salaries, it is recognized that, in an academic setting, teaching, research, service, and administration are often inextricably intermingled. A precise assessment of factors that contribute to costs is not always feasible, nor is it expected. Reliance, therefore, is placed on estimates in which a degree of tolerance is appropriate.

(d) There is no single best method for documenting the distribution of charges for personal services.

Methods for apportioning salaries and wages, however, must meet the criteria specified in J.6.b.(2) below. Examples of acceptable methods are contained in J.6.c. below. Other methods which meet the criteria specified in J.6 b (2) below also shall be deemed acceptable, if a mutually satisfactory alternative agreement is reached.

(2) *Criteria for Acceptable Methods.* (a) The payroll distribution system will (i) be incorporated into the official records of the institution, (ii) reasonably reflect the activity for which the employee is compensated by the institution, and (iii) encompass both sponsored and all other activities on an integrated basis, but may include the use of subsidiary records. (Compensation for incidental work described in J.6.a. need not be included.)

(b) The method must recognize the principle of after-the-fact confirmation or determination so that costs distributed represent actual costs, unless a mutually satisfactory alternative agreement is reached. Direct cost activities and indirect cost activities may be confirmed by responsible persons with suitable means of verification that the work was performed. Confirmation by the employee is not a requirement for either direct or indirect cost activities if other responsible persons make appropriate confirmations.

(c) The payroll distribution system will allow confirmation of activity allocable to each sponsored agreement and each of the categories of activity needed to identify indirect costs and the functions to which they are allocable. The activities chargeable to indirect cost categories or the major functions of the institution for employees whose salaries must be apportioned (see J. 6.b.1.(b) above), if not initially identified as separate categories, may be subsequently distributed by any reasonable method mutually agreed to, including, but not limited to, suitably conducted surveys, statistical sampling procedures, or the application of negotiated fixed rates.

(d) Practices vary among institutions and within institutions as to the activity constituting a full workload. Therefore, the payroll distribution system may reflect categories of activities expressed as a percentage distribution of total activities.

(e) Direct and indirect charges may be made initially to sponsored agreements on the basis of estimates made before services are performed. When such estimates are used, significant changes in the corresponding work activity must be identified and entered into the payroll distribution system. Short-term (such as one or two months) fluctation between workload categories need not be considered as long as the distribution of salaries and wages is reasonable over the longer term, such as an academic period.

(f) The system will provide for independent internal evaluations to ensure the system's effectiveness and compliance with the above standards.

(g) For systems which meet these standards, the institution will not be required to provide additional support or documentation for the effort actually performed.

J.6.C. *Examples of Acceptable Methods for Payroll Distribution:*

1. *Plan—Confirmation:* Under this method, the distribution of salaries and wages of professorial or professional staff applicable to sponsored agreements is based on budgeted, planned, or assigned work activity, updated to reflect any significant changes in work distribution. A plan-confirmation system used for salaries and wages charged directly or indirectly to sponsored agreements will meet the following standards:

(a) A system of budgeted, planned, or assigned work activity will be incorporated into the official records of the institution and encompass both sponsored and all other activities on an integrated basis. The system may include the use of subsidiary records.

(b) The system will reasonably reflect only the activity for which the employee is compensated by the institution (compensation for incidental work described in J.6.a. need not be included). Practices vary among institutions and within institutions as to the activity constituting a full workload. Hence, the system will reflect categories of activities expressed as a percentage distribution of total activities. (But see Section H for treatment of indirect costs under the simplified method for small institutions.)

(c) The system will reflect activity applicable to each sponsored agreement and to each category needed to identify indirect costs and the functions to which they are allocable. The system may treat indirect cost activities initially within a residual category and subsequently determine them by alternate methods as discussed in J.6.b.(2)(c).

(d) The system will provide for modification of an individual's salary or salary distribution commensurate with an significant change in the employee's work activity. Short-term (such as one of two months) fluctuation between workload categories need not be considered as long as the distribution of salaries and wages is reasonable over the longer term such as an academic period. Whenever it is apparent that a significant change in work activity which is directly or indirectly charged to sponsored agreements will occur or has occurred, the change will be documented over the signature of a responsible official and entered into the system.

(e) At least annually a statement will be signed by the employee, principal investigator, or responsible official(s) using suitable means of verification that the work was performed, stating that salaries and wages charged to sponsored agreements as direct charges, and to residual, indirect cost or other categories are reasonable in relation to work performed.

(f) The system will provide for independent internal evaluation to ensure the system's integrity and compliance with the above standards.

(g) In the use of this method, an institution shall not be required to provide additional support or documentation for the effort actually performed.

2. *After-the-fact Activity Records.* Under this system the distribution of salaries and wages by the institution will be supported by activity reports as prescribed below.

(a) Activity reports will reflect the distribution of activity expended by employees covered by the system (compensation for incidental work as described in J.6.a. need not be included).

(b) These reports will reflect an after-the-fact reporting of the percentage distribution of activity of employees. Charges may be made initially on the basis of estimates made before the services are performed, provided that such charges are promptly adjusted if significant differences are indicated by activity records.

(c) Reports will reasonably reflect the activities for which employees are compensated by the institution. To confirm that the distribution of activity represents a reasonable estimate of the work performed by the employee during the period, the reports will be signed by the employee, principal investigator, or responsible official(s) using suitable means of verification that the work was performed.

(d) The system will reflect activity applicable to each sponsored agreement and to each category needed to identify indirect costs and the functions to which they are allocable. The system may treat indirect cost activities initially within a residual category and subsequently determine them by alternate methods as discussed in J.6.b.(2)(c).

(e) For professorial and professional staff, the reports will be prepared each academic term, but no less frequently than every six months. For other employees, unless alternate arrangements are agreed to, the reports will be prepared no less frequently than monthly and will coincide with one or more pay periods.

(f) Where the institution uses time cards or other forms of after-the-fact payroll documents as original documentation for payroll and payroll charges, such documents shall qualify as records for this purpose provided that they meet the requirements in (a) through (e) above.

3. *Multiple Confirmation Records.* Under this system the distribution of salaries and wages of professorial and professional staff will be supported by records which certify separately for direct and indirect cost activities as prescribed below.

(a) For employees covered by the system, there will be direct cost records to reflect the distribution of that activity expended which is to be allocable as direct cost to each sponsored agreement. There will also be indirect cost records to reflect the distribution of that activity to indirect costs. These records may be kept jointly or separately (but are to be certified separately, see below).

(b) Salary and wage charges may be made initially on the basis of estimates made before the services are performed provided that such charges are promptly adjusted if significant differences occur.

(c) Institutional records will reasonably reflect only the activity for which employees are compensated by the institution (compensation for incidental work as described in J.6.a. need not be included).

(d) The system will reflect activity applicable to each sponsored agreement and to each category needed to identify indirect costs and the functions to which they are allocable.

(e) To confirm that distribution of activity represents a reasonable estimate of the work performed by the employee during the period, the record for each employee will include:

(1) The signature of the employee or of a person having direct knowledge of the work, confirming that the record of activities allocable as direct costs of each sponsored agreement is appropriate.

(2) The record of indirect costs will include the signature of responsible person(s) who use suitable means of verification that the work was performed and is consistent with the overall distribution of the employee's compensated activities.

These signatures may all be on the same document.

(f) The reports will be prepared each academic term, but no less frequently than every six months.

(g) Where the institution uses time cards or other forms of after-the-fact payroll documents as original documentation for payroll and payroll charges, such documents shall qualify as records for this purpose provided they meet the requirements in (a) through (f) above.

Related Changes

Change F.4.a.(2)(a) (in Departmental Administration Expenses) sentence 2, to read:

Salaries of professorial and professional staff whose responsibilities to the institution require administrative work that benefits sponsored projects may also be included to the extent that the portion charged to departmental administration is determined in accordance with Section J.6.

Change F.5.a. (in Sponsored Projects Administration), sentence 3, to read:

The salaries of professorial and professional staff whose responsibilities to the institution require administrative work that benefits sponsored projects may also be included to the extent that the portion charged to sponsored agreements administration is determined in accordance with Section J.6.

Change F.7.a. (in Student Administration and Services), sentence 2, to read:

The salaries of members of the academic staff whose responsibilities to the institution require administrative work that benefits sponsored projects may also be included to the extent that the portion charged to Student Administration is determined in accordance with Section J.6.

Deleted J.6.c. *Monitored Workload.*

Deleted J.6.d *Personnel Activity Reports*

Relabel J.6.e. as J.6.d.

Relabel J.6.f. as J.6.e.

Paragraph J.17.

Add at the end of section a., "except as indicated in e. below."

Add a new section e., as follows:

J.17.e. The cost of interest paid to an external party is allowable where associated with the following assets, provided the assets are used in support of sponsored agreements, and the total cost (including depreciation or use allowance, operation and maintenance costs, interest, etc.,) does not exceed the rental cost of comparable assets in the same locality.

(1) Buildings acquired or completed on or after July 1, 1982.

(2) Major reconstruction and remodeling of existing buildings completed on or after July 1, 1982.

(3) Acquisition or fabrication of capital equipment (as defined in paragraph J.13, "Equipment and other capital expenditures") completed on or after July 1, 1982, costing $10,000 or more, if agreed to by the Government.

[FR Doc. 82-20899 Filed 8-2-82; 8:45 am]

BILLING CODE 3410-01-M

Revision of Circular A-21

Circular No. A-21, Revised Transmittal Memorandum No. 2

To the Heads of Executive Departments and Establishments

SUBJECT: Cost Principles for Educational Institutions

This transmittal memorandum revises OMB Circular No. A-21, "Cost Principles for Educational Institutions," to establish a 3 percent allowance to cover the administrative work of department heads and faculty.

Effective on grants and contracts awarded on or after July 1, 1987, Circular A-21 is revised as follows:

Departmental administration expenses.

Revise F.4.a.(2)(a):

(2) Academic departments

(a) Salaries and fringe benefits attributable to the administrative work of department heads, directors of divisions and organized research units, faculty and professional staff shall be allowed at a rate of 3 percent of modified total direct costs. This allowance shall be added to the computation of the indirect cost rate for major function in section G.; the expenses covered by the allowance shall be excluded from the development and allocation of the departmental adminatration cost pool. No documentation is required to support this allowance.

General Administration and General Expenses

Add the following sentence to F.3.a.:

General administration and general expenses shall not include expenses incurred within dean's offices, academic departments, organized research units, or similar organizational units (see section F.4., departmental administration expenses).

Sponsored Projects Administration

Revise F.5.a. as follows:

(a) The expenses under this heading are limited to those incurred by a separate organization(s) established primarily to administer sponsored projects, including such functions as grant and contract administration (Federal and non-Federal) special security, purchasing , personnel administration, and editing and publishing of research and other reports. They include the salaries and expenses of the head of such organization, assistants, and immediate staff, together with the salaries and expenses of personnel engaged in supporting activities maintained by the organization, such as stock rooms, stenographic pools and the like. This category also includes an allocable share of fringe benefit costs, general administration and general expenses, operation and maintenance expenses, and depreciation/use allowances. Appropriate adjustments will be made for services priovided to other functions or organizations.

Federal agencies may authorize reimbursement of additional costs for department heads and faculty only in exceptional cases where an institution can demonstrate undue hardship or detriment to project performance.

Federal agencies are authorized to implement these changes earlier if they choose.

James G. Miller III,

Director.

[FR Doc. 86-12888 Filed 6-6-86, 8:45 am]

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federal register

Wednesday
January 28, 1981

Part X

Office of Management and Budget

Cost Principles for State and Local Governments

OFFICE OF MANAGEMENT AND BUDGET

Cost Principles for State and Local Governments

AGENCY: Office of Management and Budget.

ACTION: Final policy.

SUMMARY: This notice advises that Federal Management Circular 74–4 (Revised), dated July 18, 1974, is reissued under its original designation of Office of Management and Budget Circular No. A–87. No substantive changes are made in the Circular. The Circular is set forth below in its entirety.

EFFECTIVE DATE: The revision was effective January 15, 1981.

FOR FURTHER INFORMATION CONTACT: Palmer Marcantonio, Deputy Chief, Financial Management Branch, Budget Review Division, 6002 New Executive Office Building, Washington, D.C. 20503, 202/395–4773.

TO OBTAIN SINGLE COPIES OF THE CIRCULAR, CONTACT: Document Distribution Center, Office of Administration, G–236 New Executive Office Building, Washington, D.C. 20503.

TO OBTAIN MULTIPLE COPIES, CONTACT: Superintendent of Documents, U.S. Government Printing Office, Washington, D.C. 20402.

Daniel F. Mann,

Budget and Management Officer.

January 15, 1981.

To: The Heads of Executive Departments and Establishments.

Subject: Cost principles for State and local governments.

1. *Purpose.* This Circular establishes principles and standards for determining costs applicable to grants, contracts, and other agreements with State and local governments and federally-recognized Indian tribal governments.

2. *Supersession.* This Circular supersedes Federal Management Circular 74–4 as revised. The Circular is reissued under its original designation of OMB Circular A–87.

3. *Summary of changes.* No substantive changes are made in the Circular.

4. *Policy intent.* This Circular provides principles for determining the allowable costs of programs administered by State, local, and federally-recognized Indian tribal governments under grants from and contracts with the Federal Government. They are designed to provide the basis for a uniform approach to the problem of determining costs and to promote efficiency and better relationships between grantees and the Federal Government. The principles are for determining costs only and are not intended to identify the circumstances nor to dictate the extent of Federal and State or local participation in the financing of a particular project. They are designed to provide that federally-assisted programs bear their fair share of costs recognized under these principles except where restricted or prohibited by law. No provision for profit or other increment above cost is intended.

5. Applicability and scope.

a. The provisions of this Circular apply to all Federal agencies responsible for administering programs that involve grants and contracts with State, local, and federally-recognized Indian tribal governments.

b. Its provisions do not apply to grants and contracts with:

(1) Publicly-financed educational institutions subject to Office of Management and Budget Circular A–21, and

(2) Publicly owned hospitals and other providers of medical care subject to requirements promulgated by the sponsoring Federal agencies.

Any other exceptions will be approved by the Office of Management and Budget in particular cases where adequate justification is presented.

6. *Attachments.* The principles and related policy guides are set forth in the attachments, which are:

Attachment A—Principles for determining costs applicable to grants and contracts with State, local, and federally-recognized Indian tribal governments.

Attachment B—Standards for selected items of cost.

7. *Inquiries.* Further information concerning this Circular may be obtained by contacting the Financial Management Branch, Budget Review Division, Office of Management and Budget, Washington, D.C. 20503, telephone 202–395–4773.

James T. McIntyre, Jr.

Director.

[Circular No. A–87]

Attachment A—Principles for Determining Costs Applicable to Grants and Contracts With State, Local, and Federally Recognized Indian Tribal Governments

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A. *Purpose and scope.*

1. *Objectives.* This Attachment sets forth principles for determining the allowable costs of programs administered by State, local, and federally-recognized Indian tribal governments under grants from and contracts with the Federal Government. The principles are for the purpose of cost determination and are not intended to identify the circumstances or dictate the extent of Federal and State or local participation in the financing of a particular grant. They are designed to provide that federally-assisted programs bear their fair share of costs recognized under these principles, except where restricted or prohibited by law. No provision for profit or other increment above cost is intended.

2. *Policy guides.* The application of these principles is based on the fundamental premises that:

a. State, local, and federally recognized Indian tribal governments are responsible for the efficient and effective administration of grant and contract programs through the application of sound management practices.

b. The grantee or contractor assumes the responsibility for seeing that federally-assisted program funds have been expended and accounted for consistent with underlying agreements and program objectives.

c. Each grantee or contractor organization, in recognition of its own unique combination of staff facilities and experience, will have the primary responsibility for employing whatever form of organization and management

techniques may be necessary to assure proper and efficient administration.

3. *Application.* These principles will be applied by all Federal agencies in determining costs incurred by State, local, and federally recognized Indian tribal governments under Federal grants and cost reimbursement type contracts (including subgrants and subcontracts) except those with (a) publicly-financed educational institutions subject to Office of Management and Budget Circular A-21, and (b) publicly-owned hospitals and other providers of medical care subject to requirements promulgated by the sponsoring Federal agencies.

B. *Definitions.*

1. *Approval or authorization of the grantor Federal agency* means documentation evidencing consent prior to incurring specific cost.

2. *Cost allocation plan* means the documentation identifying, accumulating, and distributing allowable costs under grants and contracts together with the allocation methods used.

3. *Cost,* as used herein, means cost as determined on a cash, accrual, or other basis acceptable to the Federal grantor agency as a discharge of the grantee's accountability for Federal funds.

4. *Cost objective* means a pool, center, or area established for the accumulation of cost. Such areas include organizational units, functions, objects or items of expense, as well as ultimate cost objectives including specific grants, projects, contracts, and other activities.

5. *Federal agency* means any department, agency, commission, or instrumentality in the executive branch of the Federal Government which makes grants to or contracts with State, local, or federally-recognized Indian tribal governments.

6. *Federally-recognized Indian tribal governments* means the governing body or a governmental agency of any Indian tribe, band, nation, or other organized group or community (including any native village as defined in Section 3 of the Alaska Native Claims Settlement Act, 85 Stat. 688) certified by the Secretary of the Interior as eligible for the special programs and services provided by him through the Bureau of Indian Affairs.

7. *Grant* means an agreement between the Federal Government and a State, local, or federally-recognized Indian tribal government whereby the Federal Government provides funds or aid in kind to carry out specified programs, services, or activities. The principles and policies stated in this Circular as applicable to grants in general also apply to any federally-sponsored cost reimbursement-type of agreement performed by a State, local, or federally-recognized Indian tribal government.

8. *Grant program* means those activities and operations of the grantee which are necessary to carry out the purposes of the grant, including any portion of the program financed by the grantee.

9. *Grantee* means the department or agency of State, local, or federally recognized Indian tribal government which is responsible for administration of the grant.

10. *Local unit* means any political subdivision of government below the State level.

11. *Other State or local agencies* means department or agencies of the State or local unit which provide goods, facilities, and services to a grantee.

12. *Services,* as used herein, means goods and facilities, as well as services.

13. *Supporting services* means auxiliary functions necessary to sustain the direct effort involved in administering a grant program or an activity providing service to the grant program. These services may be centralized in the grantee department or in some other agency, and inlcude procurement, payroll, personnel functions, maintenance and operation of space, data processing, accounting, budgeting, auditing, mail and messenger service, and the like.

C. *Basic guidelines.*

1. *Factors affecting allowability of costs.* To allowable under a grant program, costs must meet the following general criteria:

a. Be necessary and reasonable for proper and efficient administration of the grant programs, be allocable thereto under these principles, and except as specifically provided herein, not be a general expense required to carry out the overall responsibilities of State, local or federally-recognized Indian tribal governments.

b. Be authorized or not prohibited under State or local laws or regulations.

c. Conform to any limitations or exclusions set forth in these principles, Federal laws, or other governing limitations as to types or amounts of cost items.

d. Be consistent with policies, regulations, and procedures that apply uniformly to both federally assisted and other activities of the unit of government of which the grantee is a part.

e. Be accorded consistent treatment through application of generally accepted accounting principles appropriate to the circumstances.

f. Not be allocable to or included as a cost of any other federally financed program in either the current or a prior period.

g. Be net of all applicable credits.

2. *Allocable costs.*

a. A cost is allocable to a particular cost objective to the extent of benefits received by such objective.

b. Any cost allocable to a particular grant or cost objective under the principles provided for in this Circular may not be shifted to other Federal grant programs to overcome fund deficiencies, avoid restrictions imposed by law or grant agreements, or for other reasons.

c. Where an allocation of joint cost will ultimately result in charges to a grant program, an allocation plan will be required as prescribed in Section J.

3. *Applicable credits.*

a. Applicable credits refer to those receipts or reduction of expenditure-type transactions which offset or reduce expense items allocable to grants as direct or indirect costs. Examples of such transactions are: purchase discounts; rebates or allowances, recoveries or indeminties on losses; sale of publications, equipment, and scrap; income from personal or incidental services; and adjustments of overpayments or erroneous charges.

b. Applicable credits may also arise when Federal funds are received or are available from sources other than the grant program involved to finance operations or capital items of the grantee. This includes costs arising from the use or depreciation of items donated or financed by the Federal Government to fulfill matching requirments under another grant program. These types of credits should likewise be used to reduce related expenditures in determining the rates or amounts applicable to a given grant.

D. Composition of Cost

1. *Total cost.* The total cost of a grant program is comprised of the allowable direct cost incident to its performance, plus its allocable portion of allowable indirect costs, less applicable credits.

2. *Classification of costs.* There is no universal rule for classifying certain costs as either direct or indirect under every accounting system. A cost may be direct with respect to some specific service or function, but indirect with respect to the grant or other ultimate cost objective. It is essential, therefore, that each item of cost be treated consistently either as a direct or an indirect cost. Specific guides for determining direct and indirect costs allocable under grant programs are provided in the sections which follow:

E. Direct Costs

1. *General.* Direct costs are those that can be identified specifically with a

particular cost objective. These costs may be charged directly to grants, contracts, or to other programs against which costs are finally lodged. Direct costs may also be charged to cost objectives used for the accumulation of costs pending distribution in due course to grants and other ultimate cost objectives.

2. *Application.* Typical direct costs chargeable to grant programs are:

a. Compensation of employees for the time and efforts devoted specifically to the execution of grant programs.

b. Cost of materials acquired, consumed, or expended specifically for the purpose of the grant.

c. Equipment and other approved capital expenditures.

d. Other items of expense incurred specifically to carry out the grant agreement.

e. Services furnished specifically for the grant program by other agencies, provided such charges are consistent with criteria outlined in Section G of these principles.

F. Indirect Costs

1. *General.* Indirect costs are those (a) incurred for a common or joint purpose benefiting more than one cost objective, and (b) not readily assignable to the cost objectives specifically benefited, without effort disproportionate to the results achieved. The term "indirect costs," as used herein, applies to costs of this type originating in the grantee department, as well as those incurred by other departments in supplying goods, services, and facilities, to the grantee department. To facilitate equitable distribution of indirect expenses to the cost objectives served, it may be necessary to establish a number of pools of indirect cost within a grantee department or in other agencies providing services to a grantee department. Indirect cost pools should be distributed to benefiting cost objectives on bases which will produce an equitable result in consideration of relative benefits derived.

2. *Grantee departmental indirect costs.* All grantee departmental indirect costs, including the various levels of supervision, are eligible for allocation to grant programs provided they meet the conditions set forth in this Circular. In lieu of determining the actual amount of grantee departmental indirect cost allocable to a grant program, the following methods may be used.

a. *Predetermined fixed rates for indirect costs.* A predetermined fixed rate for computing indirect costs applicable to a grant may be negotiated annually in situations where the cost experience and other pertinent facts available are deemed sufficient to enable the contracting parties to reach an informed judgment (1) as to the probable level of indirect costs in the grantee department during the period to be covered by the negotiated rate, and (2) that the amount allowable under the predetermined rate would not exceed actual indirect cost.

b. *Negotiated lump sum for overhead.* A negotiated fixed amount in lieu of indirect costs may be appropriate under circumstances where the benefits derived from a grantee department's indirect services cannot be readily determined as in the case of small, self-contained or isolated activity. When this method is used, a determination should be made that the amount negotiated will be approximately the same as the actual indirect cost that may be incurred. Such amounts negotiated in lieu of indirect costs will be treated as an offset to total indirect expenses of the grantee department before allocation to remaining activities. The base on which such remaining expenses are allocated should be appropriately adjusted.

3. *Limitation on indirect costs.*

a. Federal grants may be subject to laws that limit the amount of indirect costs that may be allowed. Agencies that sponsor grants of this type will establish procedures which will assure that the amount actually allowed for indirect costs under each such grant does not exceed the maximum allowable under the statutory limitation or the amount otherwise allowable under this Circular, whichever is the smaller.

b. When the amount allowable under a statutory limitation is less than the amount otherwise allocable as indirect costs under this Circular, the amount not recoverable as indirect costs under a grant not be shifted to another federally-sponsored grant program or contract.

G. Cost Incurred by Agencies Other Than the Grantee

1. *General.* The cost of service provided by other agencies may only include allowable direct costs of the service plus a pro rata share of allowable supporting costs (Section B.12.) and supervision directly required in performing the service, but not supervision of a general nature such as that provided by the head of a department and his staff assistants not directly involved in operations. However, supervision by the head of a department or agency whose sole function is providing the service furnished would be an eligible cost. Supporting costs include those furnished by other units of the supplying department or by other agencies.

2. *Alternative methods of determining indirect cost.* In lieu of determining actual indirect cost related to a particular service furnished by another agency, either of the following alternative methods may be used provided only one method is used for a specific service during the fiscal year involved.

a. *Standard indirect rate.* An amount equal to ten percent of direct labor cost in providing the service performed by another State agency (excluding overtime, shift, or holiday premiums and fringe benefits) may be allowed in lieu of actual allowable indirect cost for that service.

b. *Predetermined fixed rate.* A predetermined fixed rate for indirect cost of the unit or activity providing service may be negotiated as set forth in Section F.2.a.

H. Cost Incurred by Grantee Department for Others

1. *General.* The principles provided in Section G will also be used in determining the cost of services provided by the grantee department to another agency.

J. Cost Allocation Plan

1. *General.* A plan for allocation of costs will be required to support the distribution of any joint costs related to the grant program. All costs included in the plan will be supported by formal accounting records which will substantiate the propriety of eventual charges.

2. *Requirements.* The allocation plan of the grantee department should cover all joint costs of the department as well as costs to be allocated under plans of other agencies or organizational units which are to be included in the costs of federally-sponsored programs. The cost allocation plans of all the agencies rendering services to the grantee department, to the extent feasible, should be presented in a single document. The allocation plan should contain, but not necessarily be limited to, the following:

a. The nature and extent of services provided and their relevance to the federally-sponsored programs.

b. The items of expense to be included.

c. The methods to be used in distributing cost.

3. *Instructions for preparation of cost allocation plans.* The Department of Health and Human Services in consultation with the other Federal agencies concerned, will be responsible for developing and issuing the instructions for use by grantees in preparation of cost allocation plans.

This responsibility applies to both central support services at the State, local, and Indian tribal level and indirect cost proposals of individual grantee departments.

4. *Negotiation and approval of indirect cost proposals for States.*

a. The Department of Health and Human Services, in collaboration with the other Federal agencies concerned, will be responsible for negotiation, approval, and audit of cost allocation plans, which will be submitted to it by the States. These plans will cover central support service costs of the State.

b. At the grantee department level in a State, a single cognizant Federal agency will have responsibility similar to that set forth in a. above, for the negotiation, approval, and audit of the indirect cost proposal. A current list of agency assignments is maintained by the Office of Management and Budget.

c. Questions concerning the cost allocation plans approved under a. and b. above, should be directed to the agency responsible for such approvals.

5. *Negotiation and approval of indirect cost proposals for local governments.*

a. Cost allocation plans will be retained at the local government level for audit by a designated Federal agency except in those cases where that agency requests that cost allocation plans be submitted to it for negotiation and approval.

b. A list of cognizant Federal agencies assigned responsibility for negotiation, approval and audit of central support service cost allocation plans at the local government level is maintained by the the Office of Management and Budget.

c. At the grantee department level of local governments, the Federal agency with the predominant interest in the work of the grantee department will be responsible for necessary negotiation, approval and audit of the indirect cost proposal.

6. *Negotiation and approval of indirect cost proposals for federally recognized Indian tribal governments.* The Federal agency with the predominant interest in the work of the grantee department will be responsible for necessary negotiation, approval and audit of the indirect cost proposal.

7. *Resolution of problems.* To the extent that problems are encountered among the Federal agencies in connection with 4 and 5 above, the Office of Management and Budget will lend assistance as required.

[Circular No. A-87]

Attachment B—Standards for Selected Items of Costs

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A. *Purpose and applicability.*

1. *Objective.* This Attachment provides standards for determining the allowability of selected items of cost.

2. *Application.* These standards will apply irrespective of whether a particular item of cost is treated as direct or indirect cost. Failure to mention a particular item of cost in the standards is not intended to imply that it is either allowable or unallowable, rather determination of allowability in each case should be based on the treatment of standards provided for similar or related items of cost. The allowability of the selected items of cost is subject to the general policies and principles stated in Attachment A of this Circular.

B. *Allowable costs.*

1. *Accounting.* The cost of establishing and maintaining accounting and other information systems required for the management of grant programs is allowable. This includes costs incurred by central service agencies for these purposes. The cost of maintaining central accounting records required for overall State or Indian tribal government purposes, such as appropriation and fund accounts by the Treasurer, Comptroller, or similar officials, is considered to be a general expense of government and is not allowable.

2. *Advertising.* Advertising media includes newspapers, magazines, radio and television programs, direct mail, trade papers, and the like. The advertising costs allowable are those which are solely for:

a. Recruitment of personnel required for the grant program.

b. solicitation of bids for the procurement of goods and services required.

c. disposal of scrap or surplus materials acquired in the performance of the grant agreement.

d. Other purposes specifically provided for in the grant agreement.

3. *Advisory councils.* Costs incurred by State advisory councils or committees established pursuant to Federal requirements to carry out grant programs are allowable. The cost of like organizations is allowable when provided for in the grant agreement.

4. *Audit service.* The cost of audits necessary for the administration and management of functions related to grant programs is allowable.

5. *Bonding.* Costs of premiums on bonds covering employees who handle grantee agency funds are allowable.

6. *Budgeting.* Costs incurred for the development, preparation, presentation, and execution of budgets are allowable. Costs for services of a central budget office are generally not allowable since these are costs of general government. However, where employees of the central budget office actively participate in the grantee agency's budget process, the cost of identifiable services is allowable.

7. *Building lease management.* The administrative cost for lease management which includes review of lease proposals, maintenance of a list of available property for lease, and related activities is allowable.

8. *Central stores.* The cost of maintaining and operating a central stores organization for supplies, equipment, and materials used either directly or indirectly for grant programs is allowable.

9. *Communications.* Communication costs incurred for telephone calls or service, teletype service, wide area telephone service (WATS), centrex, telpak (tie lines), postage, messenger service and similar expenses are allowable.

10. *Compensation for personal services.*

a. *General.* Compensation for personal services includes all remuneration, paid currently or accured, for services rendered during the period of performance under the grant agreement, including but not necessarily limited to wages, salaries, and supplementary compensation and benefits (Section B.13.). The costs of such compensation are allowable to the extent that total compensation for individual employees: (1) is reasonable for the services rendered; (2) follows an appointment made in accordance with State, local, or Indian tribal government laws and rules and which meets Federal merit system or other requirements, where applicable; and (3) is determined and supported as provided in b. below. Compensation for employees engaged in federally-assisted activities will be considered reasonable to the extent that it is consistent with that paid for similar work in other activities of the State, local, or Indian tribal government. In cases where the kinds of employees required for the federally-assisted activities are not found in the other activities of the State, local, or Indian tribal government, compensation will be considered reasonable to the extent that it is comparable to that paid for similar work in the labor market in which the employing government competes for the kind of employees involved. Compensation surveys providing data representative of the labor market involved will be an acceptable basis for evaluating reasonableness.

b. *Payroll and distribution of time.* Amounts charged to grant programs for personal services, regardless of whether treated as direct or indirect costs, will be based on payrolls documented and provided in accordance with generally accepted practice of the State, local, or Indian tribal government. Payrolls must be supported by time and attendance or equivalent records for individual employees. Salaries and wages of employees chargeable to more than one grant program or other cost objective will be supported by appropriate time distribution records. The method used should produce an equitable distribution of time and effort.

11. *Depreciation and use allowances.*

a. Grantees may be compensated for the use of buildings, capital improvements, and equipment through use allowances or depreciation. Use allowances are the means of providing compensation in lieu of depreciation or other equivalent costs. However, a combination of the two methods may not be used in connection with a single class of fixed assets.

b. The computation of depreciation or use allowance will be based on acquisition cost. Where actual cost records have not been maintained, a reasonable estimate of the original acquisition cost may be used in the computation. The computation will exclude the cost or any portion of the cost of buildings and equipment donated or borne directly or indirectly by the Federal Government through charges to Federal grant propgrams or otherwise, irrespective of where title was originally vested or where it presently resides. In addition, the computation will also exclude the cost of land. Depreciation or a use allowance on idle or excess facilities is not allowable, except when specifically authorized by the grantor Federal agency.

c. Where the depreciation method is followed, adequate property records must be maintained, and any generally-accepted method of computing depreciation may be used. However, the method of computing depreciation must be consistently applied for any specific asset or class of assets for all affected federally-sponsored programs and must result in equitable charges considering the extent of the use of the assets for the benefit of such programs.

d. In lieu of depreciation, a use allowance for buildings and improvements may be computed at an annual rate not exceeding two percent of acquisition cost. The use allowance for equipment (excluding items properly capitalized as building cost) will be computed at an annual rate not exceeding six and two-thirds percent of acquisition cost of usuable equipment.

e. No depreciation or use charge may be allowed on any assets that would be considered as fully depreciated, provided, however, that reasonable use charges may be negotiated for any such assets if warranted after taking into consideration the cost of the facility or item involved, the estimated useful life remaining at time of negotiation, the effect of any increased maintenance charges or decreased efficiency due to age, and any other factors pertinent to the utilization of the facility or item for the purpose contemplated.

12. *Disbursing service.* The cost of disbursing grant program funds by the Treasurer or other designated officer is allowable. Disbursing services cover the processing of checks or warrants, from preparation to redemption, including the necessary records of accountability and reconciliation of such records with related cash accounts.

13. *Employee fringe benefits.* Costs identified under a. and b. below are allowable to the extent that total compensation for employees is reasonable as defined in Section B.10.

a. Employee benefits in the form of regular compensation paid to employees during periods of authorized absences from the job, such as for annual leave, sick leave, court leave, military leave, and the like, if they are: (1) provided prusuant to an approved leave system; and (2) the cost thereof is equitably allocated to all related activities, including grant programs.

b. Employee benefits in the form of employers' contribution or expenses for social security, employees' life and health insurance plans, unemployment insurance coverage, workmen's compensation insurance, pension plans, severance pay, and the like, provided such benefits are granted under approved plans and are distributed equitably to grant programs and to other activities.

14. *Employee morale, health and welfare costs.* The costs of health or first-aid clinics and/or infirmaries, recreational facilities, employees' counseling services, employee information publications, and any related expenses incurred in accordance with general State, local or Indian tribal policy, are allowable. Income generated from any of these activities will be offset against expenses.

15. *Exhibits.* Costs of exhibits relating specifically to the grant programs are allowable.

16. *Legal expenses.* The cost of legal expenses required in the administration of grant programs is allowable. Legal services furnished by the chief legal officer of a State, local or Indian tribal government or his staff solely for the purpose of discharging his general responsibilities as legal officer are unallowable. Legal expenses for the prosecution of claims against the Federal Government are unallowable.

17. *Maintenance and repair.* Costs incurred for necessary maintenance, repair, or upkeep of property which neither add to the permanent value of the property nor appreciably prolong its intended life, but keep it in an efficient operating condition, are allowable.

18. *Materials and supplies.* The cost of materials and supplies necessary to

carry out the grant programs is allowable. Purchases made specifically for the grant program should be charged thereto at their actual prices after deducting all cash discounts, trade discounts, rebates, and allowances received by the grantee. Withdrawals from general stores or stockrooms should be charged at cost under any recognized method of pricing consistently applied. Incoming transportation charges are a proper part of material cost.

19. *Memberships, subscriptions and professional activities.*

a. *Memberships.* The cost of membership in civic, business, technical and professional organizations is allowable provided: (1) the benefit from the membership is related to the grant program; (2) the expenditure is for agency membership; (3) the cost of the membership is reasonably related to the value of the services or benefits received; and (4) the expenditure is not for membership in an organization which devotes a substantial part of its activities to influencing legislation.

b. *Reference material.* The cost of books, and subscriptions to civic, business, professional, and technical periodicals is allowable when related to the grant program.

c. *Meetings and conferences.* Costs are allowable when the primary purpose of the meeting is the dissemination of technical information relating to the grant program and they are consistent with regular practices followed for other activities of the grantee.

20. *Motor pools.* The costs of a service organization which provides automobiles to user grantee agencies at a mileage or fixed rate and/or provides vehicle maintenance, inspection and repair services are allowable.

21. *Payroll preparation.* The cost of preparing payrolls and maintaining necessary related wage records is allowable.

22. *Personnel administration.* Costs for the recruitment, examination, certification, classification, training, establishment of pay standards, and related activities for grant programs, are allowable.

23. *Printing and reproduction.* Costs for printing and reproduction services necessary for grant administration, including but not limited to forms, reports, manuals, and informational literature, are allowable. Publication costs of reports or other media relating to grant program accomplishments or results are allowable when provided for in the grant agreement.

24. *Procurement service.* The cost of procurement service, including solicitation of bids, preparation and award of contracts, and all phases of contract administration in providing goods, facilities and services for grant programs, is allowable.

25. *Taxes.* In general, taxes or payments in lieu of taxes which the grantee agency is legally required to pay are allowable.

26. *Training and education.* The cost of in-service training, customarily provided for employee development, which directly or indirectly benefits grant programs is allowable. Out-of-service training involving extended periods of time is allowable only when specifically authorized by the grantor agency.

27. *Transportation.* Costs incurred for freight, cartage, express, postage and other transportation costs relating either to goods purchased, delivered, or moved from one location to another are allowable.

28. *Travel.* Travel costs are allowable for expenses for transportation, lodging, subsistence, and related items incurred by employees who are in travel status on official business incident to a grant program. Such costs may be charged on an actual basis, on a per diem or mileage basis in lieu of actual costs incurred, or on a combination of the two, provided the method used is applied to an entire trip, and results in charges consistent with those normally allowed in like circumstances in non-federally sponsored activities. The difference in cost between first-class air accommodations and less-than-first-class air accommodations are not is unallowable except when less-than-first-class air accommodations reasonably available. Notwithstanding the provisions of paragraphs D.6. and 8., travel costs of officials covered by those paragraphs, when specifically related to grant programs, are allowable with the prior approval of a grantor agency.

C. Costs Allowable With Approval of Grantor Agency

1. *Automatic data processing.* The cost of data processing services to grant programs is allowable. This cost may include rental of equipment or depreciation on grantee-owned equipment. The acquisition of equipment, whether by outright purchase, rental-purchase agreement or other method of purchase, is allowable only upon specific prior approval of the grantor Federal agency as provided under the selected item for capital expenditures.

2. *Building space and related facilities.* The cost of space in privately or publicly owned buildings used for the benefit of the grant program is allowable subject to the conditions stated below. The total cost of space, whether in a privately or publicly owned building, may not exceed the rental cost of comparable space and facilities in a privately-owned building in the same locality. The cost of space procured for grant program usage may not be charged to the program for periods of nonoccupancy, without authorization of the grantor Federal agency.

a. *Rental cost.* The rental cost of space in a privately-owned building is allowable. Similar costs for publicly owned buildings newly occupied on or after October 1, 1980, are allowable where "rental rate" systems, or equivalent systems that adequately reflect actual costs, are employed. Such charges must be determined on the basis of actual cost (including depreciation based on the useful life of the building, interest paid or accrued, operation and maintenance, and other allowable costs). Where these costs are included in rental charges, they may not be charged elsewhere. No costs will be included for purchases or construction that were originally financed by the Federal Government.

b. *Maintenance and operation.* The cost of utilities, insurance, security, janitorial services, elevator service, upkeep of grounds, normal repairs and alterations and the like, are allowable to the extent they are not otherwise included in rental or other charges for space.

c. *Rearrangements and alterations.* Costs incurred for rearrangement and alteration of facilities required specifically for the grant program or those that materially increase the value or useful life of the facilities (Section C.3.) are allowable when specifically approved by the grantor agency.

d. *Depreciation and just allowances on publicly-owned buildings.* The costs are allowable as provided in Section B.11.

e. *Occupancy of space under rental-purchase or a lease with option-to-purchase agreement.* The cost of space procured under such arrangements is allowable when specifically approved by the Federal grantor agency.

3. *Captial expenditures.* The cost of facilities, equipment, other capital assets, and repairs which materially increase the value or useful life of capital assets is allowable when such procurement is specifically approved by the Federal grantor agency. When assets acquired with Federal grant funds are (a) sold; (b) no longer available for use in a federally-sponsored program; or (c) used for purposes not authorized by the grantor agency, the Federal grantor agency's equity in the asset will be refunded in the same proportion as

Federal participation in its cost. In case any assets are traded on new items, only the net cost of the newly-acquired assets is allowable.

4. *Insurance and indemnification.*

a. Costs of insurance required, or approved and maintained pursuant to the grant agreement, are allowable.

b. Costs of other insurance in connection with the general conduct of activities are allowable subject to the following limitations:

(1) types and extent and cost of coverage will be in accordance with general State or local government policy and sound business practice.

(2) Costs of insurance or of contributions to any reserve covering the risk of loss of, or damage to, Federal Government property are unallowable except to the extent that the grantor agency has specifically required or approved such costs.

c. Contributions to a reserve for a self-insurance program approved by the Federal grantor agency are allowable to the extent that the type of coverage, extent of coverage, and the rates and premiums would have been allowed had insurance been purchased to cover the risks.

d. Actual losses which could have been covered by permissible insurance (through an approved self-insurance program or otherwise) are unallowable unless expressly provided for in the grant agreement. However, costs incurred because of losses not covered under nominal deductible insurance coverage provided in keeping with sound management practice, and minor losses not covered by insurance, such as spoilage, breakage and disappearance of small hand tools which occur in the ordinary course of operations, are allowable.

e. *Indemnification.* Includes securing the grantee against liabilities to third persons and other losses not compensated by insurance or otherwise. The Government is obligated to indemnify the grantee only to the extent expressly provided for in the grant agreement, except as provided in d. above.

5. *Management studies.* The cost of management studies to improve the effectiveness and efficiency of grant management for ongoing programs is allowable except that the cost of studies performed by agencies other than the grantee department or outside consultants is allowable only when authorized by the Federal grantor agency.

6. *Preagreement costs.* Costs incurred prior to the effective date of the grant or contract, whether or not they would have been allowable thereunder if incurred after such date, are allowable when specifically provided for in the grant agreement.

7. *Professional services.* Costs of professional services rendered by individuals or organizations not a part of the grantee department are allowable subject to such prior authorization as may be required by the Federal grantor agency.

8. *Proposal costs.* Costs of preparing proposals on potential Federal Government grant agreements are allowable when specifically provided for in the grant agreement.

D. Unallowable Costs

1. *Bad debts.* Any losses arising from uncollectible accounts and other claims, and related costs, are unallowable.

2. *Contingencies.* Contributions to a contingency reserve or any similar provision for unforeseen events are unallowable.

3. *Contributions and donations.* Unallowable.

4. *Entertainment.* Costs of amusements, social activities, and incidental costs relating thereto, such as meals, beverages, lodgings, rentals, transportation, and gratuities, are unallowable.

5. *Fines and penalties.* Costs resulting from violations of, or failure to comply with Federal, State and local laws and regulations are unallowable.

6. *Governor's expenses.* The salaries and expenses of the Office of the Governor of a State, or the chief executive of a political subdivision, are considered a cost of general State or local government and are unallowable. However, for a federally-recognized Indian tribal government, only that portion of the salaries and expenses of the office of the chief executive that is a cost of general government is unallowable. The portion of salaries and expenses directly attributable to managing and operating programs by the chief executive and his staff is allowable. The allowable portion shall be determined by the Federal cognizant agency and the Indian government representative on a reasonable basis.

7. *Interest and other financial costs.* Interest on borrowings (however represented), bond discounts, cost of financing and refinancing operations, and legal and professional fees paid in connection therewith, are unallowable except when authorized by Federal legislation and except as provided for in paragraph C.2.a of this Attachment.

8. *Legislative expenses.* Salaries and other expenses of the State legislature or similar local governmental bodies such as county supervisors, city councils, school boards, etc., whether incurred for purposes of legislation or executive direction, are unallowable.

9. *Underrecovery of costs under grant agreements.* Any excess of cost over the Federal contribution under one grant agreement is unallowable under other grant agreements.

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Tuesday
July 8, 1980

Note: This reprint incorporates corrections published at 46 FR 17185, Tuesday, March 17, 1981.

Part III

Office of Management and Budget

Circular A-122, "Cost Principles for Nonprofit Organizations"

Original A-122

OFFICE OF MANAGEMENT AND BUDGET

Circular A-122, "Cost Principles for Nonprofit Organizations"

[Note: This reprint incorporates corrections published at 46 FR 17185, Tuesday, March 17, 1981.]

AGENCY: Office of Management and Budget.

ACTION: Final Policy.

SUMMARY: This notice advises of a new OMB Circular dealing with principles for determining costs of grants, contracts, and other agreements with nonprofit organizations.

The Circular is the product of an interagency review conducted over a two-year period. Its purpose is to provide a set of cost principles to replace existing principles issued by individual agencies. These have often contained varying and conflicting requirements, and created confusion among agency administrators, auditors, and nonprofit officials. The new Circular will provide a uniform approach to the problem of determining costs, and promote efficiency and better understanding between recipients and the Federal Government.

EFFECTIVE DATE: The Circular becomes effective on issuance.

FOR FURTHER INFORMATION CONTACT: Palmer A. Marcantonio, Financial Management Branch, Office of Management and Budget, Washington, D.C. 20503, (202) 395-4773.

SUPPLEMENTARY INFORMATION: Before the Circular became final there was extensive coordination with the affected nonprofit organizations, professional associations, Federal agencies and others. All interested persons were given an opportunity to comment on the proposed Circular through informal consultations and a notice in the **Federal Register**. In response to our requests for comment, we received about 100 letters from Federal agencies, nonprofit organizations, associations, and other interested members of the public. These comments were considered in the final version of the Circular. There follows a summary of the major comments and the action taken on each.

In addition to the changes described, other changes have been made to improve the clarity and readability of the Circular. To the extent possible, we have tried to make the language of this Circular consistent with that of cost principles for educational institutions (Circular A-21), and State and local governments (Circular 74-4).

Summary of Significant Changes:

Set forth are changes that have been made in the final Circular as a result of public comments. The more significant changes to the basic Circular and Attachment A include:

1. Paragraph 2, "Supersession" was added to the basic Circular to make it clear that this Circular supersedes cost principles issued by individual agencies.

2. Paragraph 4 of the basic Circular has been amended to make it clear that the absence of an advance agreement on any element of cost will not in itself affect the reasonableness of allocability of that element. Also, this paragraph was amended to make it clear that where an item of cost requiring prior approval is specified in the budget, approval of the budget constitutes approval of the cost.

3. Paragraph 5 of the basic Circular has been changed to remove any doubt as to which nonprofit organizations would not be covered by the Circular. Now, Appendix C to the Circular lists all exclusions.

4. Paragraph 8 was added to the basic Circular to permit Federal agencies to request exceptions from the requirements of the Circular.

5. Paragraph E.2. was added to Attachment A to cover the negotiation and approval of indirect cost rates, and to provide for cognizance arrangements.

The more significant changes to Attachment B to the Circular include:

1. Paragraph 8, *Compensation for Personal Services*, was modified to:

a. Permit Federal agencies to accept a substitute system for documenting personnel costs through means other than personnel activity reports.

b. Clarify provisions covering the allowability of costs for unemployment compensation or workers' compensation, and costs of insurance policies on the lives of trustees, officers, or other employees.

c. Make unallowable any increased costs of pension plans caused by delayed funding.

d. Delete a paragraph dealing with review and approval of compensation of individual employees.

2. Paragraph 7, *Contingencies*, was changed to make it clear that the term "contingency reserves" excludes self-insurance reserves or pension funds.

3. Paragraph 10 was modified to provide that the value of donated services used in the performance of a direct cost activity shall be allocated a share of indirect cost only when (a) the aggregate value of the service is material, (b) the services are supported by a significant amount of the indirect cost incurred by the organization, and (c) the direct cost activity is not pursued primarily for the benefit of the Federal Government. Provisions were also added to this paragraph for the cognizant agency and the recipient to negotiate when there is no basis for determining the fair market value of the services rendered, and to permit indirect costs allocated to donated services to be charged to an agreement or used to meet cost sharing or matching requirements.

4. Paragraph 13, *Equipment and Other Capital Expenditures*, was changed. Capital equipment is now defined as having an acquisition cost of $500 and a useful life of more than two years.

5. Paragraph 24, *Meetings, Conferences*. The prior approval requirement for charging meetings and conferences as a direct cost was deleted. A sentence was added to make it clear such costs were allowable provided they meet the criterion for the allowability of cost shown in Attachment A.

6. Paragraph 26, *Organization Costs*, was amended to provide that organization costs may be allowable when approved in writing by the awarding agency.

7. Paragraph 28, *Page Charges in Professional Journals*, was revised to provide that page charges may be allowable.

8. Paragraph 36, *Public Information Service Costs*, was modified to make public information costs allowable as direct costs with awarding agency approval.

9. Paragraph 42, *Rental Costs*, was rewritten to:

a. Make it clear that rental costs under leases which create a material equity on the leased property are allowable only up to the amount that the organization would have been allowed had it purchased the property; e.g., depreciation or use allowances, maintenance, taxes, insurance, etc.

b. Clarify the criteria for material equity leases.

10. Paragraph 50, *Travel Costs*, was amended to delete the prior approval requirement for domestic travel. In addition to the above, a number of editorial changes were made to the original document.

Suggested Changes Not Considered Necessary.

Comment. Several respondents questioned the provision that, for "less than arm's length" leases, rental costs are allowable only up to the amount that would be allowed had title to the property been vested in the grantee organization. In their opinion this rule will result in unnecessary cost to the Federal Government, since it would encourage an organization to lease space on the commercial market at a higher rate.

Response. The cost principles are designed to cover most situations; however, there are always exceptions that must be considered on a case-by-case basis. The Circular contains a provision for Federal agencies to request exceptions.

Comment. Several respondents questioned why interest is not an allowable cost, since it is an ordinary and necessary cost of doing business.

Response. It has been a longstanding policy not to recognize interest as a cost. However, this policy has recently been revised for State and local governments in Circular 74–4, with respect to the cost of office space. The revision provides that "rental" rates for publicly owned buildings may be based on actual costs, including depreciation, interest, operation and maintenace costs, and other allowable costs. This revision was under consideration for some time. It was studied extensively by OMB, the General Accounting Office and others, and considerable analysis went into its formulation. Suggestions for extending it to nonprofit organizations would have to be examined with equal care. This has not yet been done; and we were reluctant to further delay issuance of this Circular.

Comment. Several respondents questioned why public information costs were not allowable as an indirect cost.

Response. Public information costs are often direct services to an organization's other programs. They are allowable, however, as a direct charge when they are within the scope of work of a particular agreement.

Comment. One respondent suggested that smaller grantees be excluded from complying with the Circular.

Response. Similar rules for the 50 selected items of cost would be needed regardless of the size of the grantee. To the extent possible, the Circular provides simplified methods for smaller grantees.

Comment. One respondent said the requirements of the Cost Accounting Standards Board should be applied to cover contracts with nonprofit organizations.

Response. It is unlikely that the type of grantees covered by this Circular would have contracts large enough to be covered by the CASB. In the event that they do, however, the regulations of the CASB would apply.

Comment. One respondent said the allocation of indirect cost to donated services would pose a tremendous difficulty to the organization. The organization relies on a corps of approximately 8,000 committee members to carry out obligations in response to Government requests. There is no employer relationship in the arrangements for this assistance, nor are there committee members normally reimbursed for such services. Further, it was pointed out the committee members spend many thousands of hours outside the organization's premises conducting research.

Response. It would appear that this type of committee arrangement would not be considered in the determination of the organization's indirect cost rate provided that Federal agreements do not bear an unreasonable share of indirect cost. However, the cognizant agency will be responsible for evaluating the allocation of indirect cost where there are committee-type arrangements on a case-by-case basis.

Comment. One respondent suggested that wherever possible the language in the *Federal Procurement Regulations* be used for nonprofit organizations.

Response. The language in the *Federal Procurement Regulations* was designated primarily for commercial firms, and is not necessarily well suited to nonprofit organizations. At the suggestion of the General Accounting Office, the nonprofit cost principles were written to conform as closely as possible to those of educational institutions (Circular A–21), and State and local governments (Circular 74–4).

John J. Lordan,

Chief, Financial Management Branch.

[Circular No. A–122]

June 27, 1980

To The Heads of Executive Departments and Establishments

Subject: Cost principles for nonprofit organizations.

1. *Purpose.* This Circular establishes principles for determining costs of grants, contracts and other agreements with nonprofit organizations. It does not apply to colleges and universities which are covered by Circular A–21; State, local, and federally recognized Indian tribal governments which are covered by Circular 74–4; or hospitals. The principles are designed to provide that the Federal Government bear its fair share of costs except where restricted or prohibited by law. The principles do not attempt to prescribe the extent of cost sharing or matching on grants, contracts, or other agreements. However, such cost sharing or matching shall not be accomplished through arbitrary limitations on individual cost elements by Federal agencies. Provision for profit or other increment above cost is outside the scope of this Circular.

2. *Supersession.* This Circular supersedes cost principles issued by individual agencies for nonprofit organization.

3. *Applicability.* a. These principles shall be used by all Federal agencies in determining the costs of work performed by nonprofit organizations under grants, cooperative agreements, cost reimbursement contracts, and other contracts in which costs are used in pricing, administration, or settlement. All of these instruments are hereafter referred to as awards. The principles do not apply to awards under which an organization is not required to account to the Government for actual costs incurred.

b. All cost reimbursement subawards (subgrants, subcontracts, etc.) are subject to those Federal cost principles applicable to the particular organization concerned. Thus, if a subaward is to a nonprofit organization, this Circular shall apply; if a subaward is to a commercial organization, the cost principles applicable to commercial concerns shall apply; if a subaward is to a college or university, Circular A–21 shall apply; if a subaward is to a State, local, or federally recognized Indian tribal government, Circular 74–4 shall apply.

4. *Definitions.* a. *"Nonprofit organization"* means any corporation, trust, association, cooperative, or other organization which (1) is operated primarily for scientific, educational, service, charitable, or similar purposes in the public interest; (2) is not organized primarily for profit; and (3) uses its net proceeds to maintain, improve, and/or expand its operations. For this purpose, the term "nonprofit organization" excludes (i) colleges and universities; (ii) hospitals; (iii) State, local, and federally recognized Indian tribal governments; and (iv) those nonprofit organizations which are excluded from coverage of this Circular in accordance with paragraph 5 below.

b. *"Prior approval"* means securing the awarding agency's permission in advance to incur cost for those items that are designated as requiring prior approval by the Circular. Generally this permission will be in writing. Where an item of cost requiring prior approval is specified in the budget of an award, approval of the budget constitutes approval of that cost.

5. *Exclusion of some nonprofit organizations.* Some nonprofit organizations, because of their size and nature of operations, can be considered to be similar to commercial concerns for purpose of applicability of cost principles. Such nonprofit organizations shall operate under Federal cost principles applicable to commercial concerns. A listing of these

organizations is contained in Attachment C. Other organizations may be added from time to time.

6. *Responsibilities.* Agencies responsible for administering programs that involve awards to nonprofit organizations shall implement the provisions of this Circular. Upon request, implementing instruction shall be furnished to the Office of Management and Budget. Agencies shall designate a liaison official to serve as the agency representative on matters relating to the implementation of this Circular. The name and title of such representative shall be furnished to the Office of Management and Budget within 30 days of the date of this Circular.

7. *Attachments.* The principles and related policy guides are set forth in the following Attachments:

Attachment A—General Principles
Attachment B—Selected Items of Cost
Attachment C—Nonprofit Organizations Not Subject to This Circular

8. *Requests for exceptions.* The Office of Management and Budget may grant exceptions to the requirements of this Circular when permissible under existing law. However, in the interest of achieving maximum uniformity, exceptions will be permitted only in highly unusual circumstances.

9. *Effective Date.* The provisions of this Circular are effective immediately. Implementation shall be phased in by incorporating the provisions into new awards made after the start of the organization's next fiscal year. For existing awards the new principles may be applied if an organization and the cognizant Federal agency agree. Earlier implementation, or a delay in implementation of individual provisions is also permitted by mutual agreement between an organization and the cognizant Federal agency.

10. *Inquiries.* Further information concerning this Circular may be obtained by contacting the Financial Management Branch, Budget Review Division, Office of Management and Budget, Washington, D.C. 20503, telephone (202) 395–4773.

James T. McIntyre, Jr.,
Director.

[Circular No. A–122]

Attachment A

General Principles

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[Circular No. A–122]

Attachment A

General Principles

A. Basic Considerations.

1. *Composition of total costs.* The total cost of an award is the sum of the allowable direct and allocable indirect costs less any applicable credits.

2. *Factors affecting allowability of costs.* To be allowable under an award, costs must meet the following general criteria:

a. Be reasonable for the performance of the award and be allocable thereto under these principles.

b. Conform to any limitations or exclusions set forth in these principles or in the award as to types or amount of cost items.

c. Be consistent with policies and procedures that apply uniformly to both federally financed and other activities of the organization.

d. Be accorded consistent treatment.

e. Be determined in accordance with generally accepted accounting principles.

f. Not be included as a cost or used to meet cost sharing or matching requirements of any other federally financed program in either the current or a prior period.

g. Be adequately documented.

3. *Reasonable costs.* A cost is reasonable if, in its nature or amount, it does not exceed that which would be incurred by a prudent person under the circumstances prevailing at the time the decision was made to incur the costs. The question of the reasonableness of specific costs must be scrutinized with particular care in connection with organizations or separate divisions thereof which receive the preponderance of their support from awards made by Federal agencies. In determining the reasonableness of a given cost, consideration shall be given to:

a. Whether the cost is of a type generally recognized as ordinary and necessary for the operation of the organization or the performance of the award.

b. The restraints or requirements imposed by such factors as generally accepted sound business practices, arms length bargaining, Federal and State laws and regulations, and terms and conditions of the award.

c. Whether the individuals concerned acted with prudence in the circumstances, considering their responsibilities to the organization, its members, employees, and clients, the public at large, and the Government.

d. Significant deviations from the established practices of the organization which may unjustifiably increase the award costs.

4. *Allocable costs.*

a. A cost is allocable to a particular cost objective, such as a grant, project, service, or other activity, in accordance with the relative benefits received. A cost is allocable to a Government award if it is treated consistently with other costs incurred for the same purpose in like circumstances and if it:

(1) Is incurred specifically for the award.

(2) Benefits both the award and other work and can be distributed in reasonable proportion to the benefits received, or

(3) Is necessary to the overall operation of the organization, although a direct relationship to any particular cost objective cannot be shown.

b. Any cost allocable to a particular award or other cost objective under these principles may not be shifted to other Federal awards to overcome funding deficiencies, or to avoid restrictions imposed by law or by the terms of the award.

5. *Applicable credits.*

a. The term applicable credits refers to those receipts, or reduction of expenditures which operate to offset or reduce expense items that are allocable to awards as direct or indirect costs. Typical examples of such transactions are: purchase discounts, rebates or allowances, recoveries or indemnities on losses, insurance refunds, and adjustments of overpayments or erroneous charges. To the extent that such credits accruing or received by the organization relate to allowable cost they shall be credited to the Government either as a cost reduction or cash refund as appropriate.

b. In some instances, the amounts received from the Federal Government to finance organizational activities or service operations should be treated as applicable credits. Specifically, the concept of netting such credit items against related expenditures should be applied by the organization in determining the rates or amounts to be charged to Federal awards for services rendered whenever the facilities or other resources used in providing such services have been financed directly, in whole or in part, by Federal funds.

(c) For rules covering program income (i.e., gross income earned from federally supported activities) see Attachment D of OMB Circular A–110.

6. *Advance understandings.* Under any given award the reasonableness and allocability of certain items of costs may be difficult to determine. This is particularly true in connection with organizations that receive a preponderance of their support from Federal agencies. In order to avoid subsequent disallowance or dispute based on unreasonableness or nonallocability, it is often desirable to seek a written agreement with the cognizant or awarding agency in advance of the incurrence of special or unusual costs. The absence of an advance agreement on any element of cost will not, in itself, affect the reasonableness or allocability of that element.

B. Direct Costs

1. Direct costs are those that can be identified specifically with a particular final cost objective: i.e., a particular award, project, service, or other direct activity of an organization. However, a cost may not be assigned to an award as a direct cost if any other cost incurred for the same purpose, in like circumstances, has been allocated to an award as an indirect cost. Costs identified specifically with awards are direct costs of the awards and are to be assigned directly thereto. Costs identified specifically with other final cost objectives of the organization are direct costs of those cost objectives and are not to be assigned to other awards directly or indirectly.

2. Any direct cost of a minor amount may be treated as an indirect cost for reasons of practicality where the accounting treatment for such cost is consistently applied to all final cost objectives.

3. The cost of certain activities are not allowable as charges to Federal awards (see, for example, fund raising costs in paragraph 19 of Attachment B). However, even though these costs are unallowable for purposes of computing charges to Federal awards, they nonetheless must be treated as direct cost for purposes of determining indirect cost rates and be allocated their share of the organization's indirect costs if they represent activities which (1) include the salaries of personnel, (2) occupy space, and (3) benefit from the organization's indirect costs.

4. The costs of activities performed primarily as a service to members, clients, or the general public when significant and necessary to the organization's mission must be treated as direct costs whether or not allowable and be allocated an equitable share of indirect costs. Some examples of these types of activities include:

a. Maintenance of membership rolls, subscriptions, publications, and related functions.

b. Providing services and information to members, legislative or administrative bodies, or the public.

c. Promotion, lobbying, and other forms of public relations.

d. Meetings and conferences except those held to conduct the general administration of the organization.

3. Maintenance, protection, and investment of special funds not used in operation of the organization.

f. Administration of group benefits on behalf of members or clients including life and hospital insurance, annuity or retirement plans, financial aid, etc.

C. Indirect Cost.

1. Indirect costs are those that have been incurred for common or joint objectives and cannot be readily identified with a particular final cost objective. Direct cost of minor amounts may be treated as indirect costs under the conditions described in paragraph B.2. above. After direct costs have been determined and assigned directly to awards or other work as appropriate, indirect costs are those remaining to be allocated to benefiting cost objectives. A cost may not be allocated to an award as an indirect cost if any other cost incurred for the same purpose, in like circumstances, has been assigned to an award as a direct cost.

2. Because of the diverse characteristics and accounting practices of nonprofit organizations, it is not possible to specify the types of costs which may be classified as indirect cost in all situations. However, typical examples of indirect cost for many nonprofit organizations may include depreciation or use allowances on buildings and equipment, the costs of operating and maintaining facilities, and general administration and general expenses, such as the salaries and expenses of executive officers, personnel administration, and accounting.

D. Allocation of Indirect Costs and Determination of Indirect Cost Rates.

1. *General.*

a. Where a nonprofit organization has only one major function, or where all its major functions benefit from its indirect costs to approximately the same degree, the allocation of indirect costs and the computation of an indirect cost rate may be accomplished through simplified allocation procedures as described in paragraph 2 below.

b. Where an organization has several major functions which benefit from its indirect costs in varying degrees, allocation of indirect costs may require the accumulation of such costs into separate cost groupings which then are allocated individually to benefiting functions by means of a base which best measures the relative degree of benefit. The indirect costs allocated to each function are then distributed to individual awards and other activities included in that function by means of an indirect cost rate(s).

c. The determination of what constitutes an organization's major functions will depend on its purpose in being; the types of services it renders to the public, its clients, and its members; and the amount of effort it devotes to such activities as fund raising, public information and membership activities.

d. Specific methods for allocating indirect costs and computing indirect cost rates along with the conditions under which each method should be used are described in paragraphs 2 through 5 below.

e. The base period for the allocation of indirect costs is the period in which such costs are incurred and accumulated for allocation to work performed in that period. The base period normally should coincide with the organization's fiscal year, but in any event, shall be so selected as to avoid inequities in the allocation of the costs.

2. *Simplified allocation method.*

a. Where an organization's major functions benefit from its indirect costs to approximately the same degree, the allocation of indirect costs may be accomplished by (i) separating the organization's total costs for the base period as either direct or indirect, and (ii) dividing the total allowable indirect costs (net of applicable credits) by an equitable distribution base. The result of this process is an indirect cost rate which is used to distribute indirect costs to individual awards. The rate should be expressed as the percentage which the total amount of allowable indirect costs bears to the base selected. This method should also be used where an organization has only one major function encompassing a number of individual projects or activities, and may be used where the level of Federal awards to an organization is relatively small.

b. Both the direct costs and the indirect costs shall exclude capital expenditures and unallowable costs. However, unallowable costs which represent activities must be included in the direct costs under the conditions described in paragraph B.3. above.

c. The distribution base may be total direct costs (excluding capital expenditures and other distorting items, such as major subcontracts or subgrants), direct salaries and wages, or other base which results in an equitable distribution. The distribution base shall generally exclude participant support costs as defined in paragraph 29 of Attachment B.

d. Except where a special rate(s) is required in accordance with paragraph D.5 below, the indirect cost rate developed under the above principles is applicable to all awards at the organization. If a special rate(s) is required, appropriate modifications shall be made in order to develop the special rate(s).

3. *Multiple allocation base method.*

a. Where an organization's indirect costs benefit its major functions in varying degrees, such costs shall be accumulated into separate cost groupings. Each grouping shall then be allocated individually to benefiting functions by means of a base which best measures the relative benefits.

b. The groupings shall be established so as to permit the allocation of each grouping on the basis of benefits provided to the major functions. Each grouping should constitute a pool of expenses that are of like character in terms of the functions they benefit and in terms of the allocation base which best measures the relative benefits provided to each function. The number of separate groupings should be held within practical limits, taking into consideration the materiality of the amounts involved and the degree of precision desired.

c. Actual conditions must be taken into account in selecting the base to be used in allocating the expenses in each grouping to benefiting functions. When an allocation can be made by assignment of a cost grouping directly to the function benefited, the allocation shall be made in that manner. When the expenses in a grouping are more general in nature, the allocation should be made through the use of a selected base which produces results that are equitable to both the Government and the organization. In general, any cost element or cost related factor associated with the organization's work is potentially adaptable for use as an allocation base provided (i) it can readily be expressed in terms of dollars or other quantitative measures (total direct costs, direct salaries and wages, staff hours applied, square feet used, hours of usage, number of documents processed, population served, and the like) and (ii) it is common to the benefiting functions during the base period.

d. Except where a special indirect cost rate(s) is required in accordance with

paragraph D.3. below, the separate groupings of indirect costs allocated to each major function shall be aggregated and treated as a common pool for that function. The costs in the common pool shall then be distributed to individual awards included in that function by use of a single indirect cost rate.

e. The distribution base used in computing the indirect cost rate for each function may be total direct costs (excluding capital expenditures and other distorting items such as major subcontracts and subgrants), direct salaries and wages, or other base which results in an equitable distribution. The distribution base shall generally exclude participant support costs as defined in paragraph 29, Attachment B. An indirect cost rate should be developed for each separate indirect cost pool developed. The rate in each case should be stated as the percentage which the amount of the particular indirect cost pool is of the distribution base identified with that pool.

4. *Direct allocation method.*

a. Some nonprofit organizations, treat all costs as direct costs except general administration and general expenses. These organizations generally separate their costs into three basic categories: (i) General administration and general expenses, (ii) fund raising, and (iii) other direct functions (including projects performed under Federal awards). Joint costs, such as depreciation, rental costs, operation and maintenance of facilities, telephone expenses, and the like are prorated individually as direct costs to each category and to each award or other activity using a base most appropriate to the particular cost being prorated.

b. This method is acceptable provided each joint cost is prorated using a base which accurately measures the benefits provided to each award or other activity. The bases must be established in accordance with reasonable criteria, and be supported by current data. This method is compatible with the Standards of Accounting and Financial Reporting for Voluntary Health and Welfare Organizations issued jointly by the National Health Council, Inc., the National Assembly of Voluntary Health and Social Welfare Organizations, and the United Way of America.

c. Under this method, indirect costs consist exclusively of general administration and general expenses. In all other respects, the organization's indirect cost rates shall be computed in the same manner as that described in paragraph D.2 above.

5. *Special indirect cost rates.* In some instances, a single indirect cost rate for all activities of an organization or for each major function of the organization may not be appropriate, since it would not take into account those different factors which may substantially affect the indirect costs applicable to a particular segment of work. For this purpose, a particular segment of work may be that performed under a single award or it may consist of work under a group of awards performed in a common environment. The factors may include the physical location of the work, the level of administrative support required, the nature of the facilities or other resources employed, the scientific disciplines or technical skills involved, the organizational arrangements used, or any combination thereof. When a particular segment of work is performed in an environment which appears to generate a significantly different level of indirect costs, provisions should be made for a separate indirect cost pool applicable to such work. The separate indirect cost pool should be developed during the course of the regular allocation process, and the separate indirect cost rate resulting therefrom should be used provided it is determined that (i) the rate differs significantly from that which would have been obtained under paragraph D.2, 3, and 4 above, and (ii) the volume of work to which the rate would apply is material.

E. Negotiation and Approval of Indirect Cost Rates.

1. *Definitions.* As used in this section, the following terms have the meanings set forth below:

a. "Cognizant agency" means the Federal agency responsible for negotiating and approving indirect cost rates for a nonprofit organization on behalf of all Federal agencies.

b. "Predetermined rate" means an indirect cost rate, applicable to a specified current or future period, usually the organization's fiscal year. The rate is based on an estimate of the costs to be incurred during the period. A predetermined rate is not subject to adjustment.

c. "Fixed rate" means an indirect cost rate which has the same characteristics as a predetermined rate, except that the difference between the estimated costs and the actual costs of the period covered by the rate is carried forward as an adjustment to the rate computation of a subsequent period.

d. "Final rate" means an indirect cost rate applicable to a specified past period which is based on the actual costs of the period. A final rate is not subject to adjustment.

e. "Provisional rate" or billing rate means a temporary indirect cost rate applicable to a specified period which is used for funding, interim reimbursement, and reporting indirect costs on awards pending the establishment of a final rate for the period.

f. "Indirect cost proposal" means the documentation prepared by an organization to substantiate its claim for the reimbursement of indirect costs. This proposal provides the basis for the review and negotiation leading to the establishment of an organization's indirect cost rate.

g. "Cost objective" means a function, organizational subdivision, contract, grant, or other work unit for which cost data are desired and for which provision is made to accumulate and measure the cost of processes, projects, jobs and capitalized projects.

2. *Negotiation and approval of rates.*

a. Unless different arrangements are agreed to by the agencies concerned, the Federal agency with the largest dollar value of awards with an organization will be designated as the cognizant agency for the negotiation and approval of indirect cost rates and, where necessary, other rates such as fringe benefit and computer charge-out rates. Once an agency is assigned cognizance for a particular nonprofit organization, the assignment will not be changed unless there is a major long-term shift in the dollar volume of the Federal awards to the organization. All concerned Federal agencies shall be given the opportunity to participate in the negotiation process, but after a rate has been agreed upon it will be accepted by all Federal agencies. When a Federal agency has reason to believe that special operating factors affecting its awards necessitate special indirect cost rates in accordance with paragraph D.5 above, it will, prior to the time the rates are negotiated, notify the cognizant agency.

b. A nonprofit organization which has not previously established an indirect cost rate with a Federal agency shall submit its initial indirect cost proposal to the cognizant agency. The proposal shall be submitted as soon as possible after the organization is advised that an award will be made and, in no event, later than three months after the effective date of the award.

c. Organizations that have previously established indirect cost rates must submit a new indirect cost proposal to the cognizant agency within six months after the close of each fiscal year.

d. A predetermined rate may be negotiated for use on awards where there is reasonable assurance, based on past experience and reliable projection of the organization's costs, that the rate is not likely to exceed a rate based on the organization's actual costs.

e. Fixed rates may be negotiated where predetermined rates are not considered appropriate. A fixed rate, however, shall not be negotiated if (i) all or a substantial portion of the organization's awards are expected to expire before the carry-forward adjustment can be made; (ii) the mix of Government and non-government work at the organization is too erratic to permit an equitable carry-forward adjustment; or (iii) the organization's operations fluctuate significantly from year to year.

f. Provisional and final rates shall be negotiated where neither predetermined nor fixed rates are appropriate.

g. The results of each negotiation shall be formalized in a written agreement between the cognizant agency and the nonprofit organization. The cognizant agency shall distribute copies of the agreement to all concerned Federal agencies.

h. If a dispute arises in a negotiation of an indirect cost rate between the cognizant agency and the nonprofit organization, the dispute shall be resolved in accordance with the appeals procedures of the cognizant agency.

i. To the extent that problems are encountered among the Federal agencies in connection with the negotiation and approval process, the Office of Management and Budget will lend assistance as required to resolve such problems in a timely manner.

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Selected Items of Cost

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[Circular No. A-122]

Attachment B

Selected Items of Cost

Paragraphs 1 through 50 provide principles to be applied in establishing the allowability of certain items of cost. These principles apply whether a cost is treated as direct or indirect. Failure to mention a particular item of cost is not intended to imply that it is unallowable; rather determination as to allowability in each case should be based on the treatment or principles provided for similar or related items of cost.

1. *Advertising costs.*

a. Advertising costs mean the costs of media services and associated costs. Media advertising includes magazines, newspapers, radio and television programs, direct mail, exhibits, and the like.

b. The only advertising costs allowable are those which are solely for (i) the recruitment of personnel when considered in conjunction with all other recruitment costs, as set forth in paragraph 40; (ii) the procurement of goods and services; (iii) the disposal of surplus materials acquired in the performance of the award except when organizations are reimbursed for disposals at a predetermined amount in accordance with Attachment N of OMB Circular A-110; or (iv) specific requirements of the award.

2. *Bad debts.* Bad debts, including losses (whether actual or estimated) arising from uncollectible accounts and other claims, related collection costs, and related legal costs, are unallowable.

3. *Bid and proposal costs.* (reserved)

4. *Bonding costs.*

a. Bonding costs arise when the Government requires assurance against financial loss to itself or others by reason of the act or default of the organization. They arise also in instances where the organization requires similar assurance. Included are such bonds as bid, performance, payment, advance payment, infringement, and fidelity bonds.

b. Costs of bonding required pursuant to the terms of the award are allowable.

c. Costs of bonding required by the organization in the general conduct of its operations are allowable to the extent that such bonding is in accordance with sound business practice and the rates and premiums are reasonable under the circumstances.

5. *Communication costs.* Costs incurred for telephone services, local and long distance telephone calls, telegrams, radiograms, postage and the like, are allowable.

6. *Compensation for personal services.*

a. *Definition.* Compensation for personal services includes all compensation paid currently or accrued by the organization for services of employees rendered during the period of the award (except as otherwise provided in paragraph g. below). It includes, but is not limited to, salaries, wages, director's and executive committee member's fees, incentive awards, fringe benefits, pension plan costs, allowances for off-site pay, incentive pay, location allowances, hardship pay, and cost of living differentials.

b. *Allowability.* Except as otherwise specifically provided in this paragraph, the costs of such compensation are allowable to the extent that:

(1) Total compensation to individual employees is reasonable for the services rendered and conforms to the established policy of the organization consistently applied to both Government and non-Government activities; and

(2) Charges to awards whether treated as direct or indirect costs are determined and supported as required in this paragraph.

c. *Reasonableness.*

(1) When the organization is predominantly engaged in activities other than those sponsored by the Government, compensation for employees on Government-sponsored work will be considered reasonable to the extent that it is consistent with that paid for similar work in the organization's other activities.

(2) When the organization is predominantly engaged in Government-sponsored activities and in cases where the kind of employees required for the Government activities are not found in the organization's other activities, compensation for employees on Government-sponsored work will be considered reasonable to the extent that it is comparable to that paid for similar work in the labor markets in which the organization competes for the kind of employees involved.

d. *Special considerations in determining allowability.* Certain conditions require special consideration and possible limitations in determining costs under Federal awards where amounts or types of compensation appear unreasonable. Among such conditions are the following:

(1) Compensation to members of nonprofit organizations, trustees, directors, associates, officers, or the immediate families thereof. Determination should be made that such compensation is reasonable for the actual personal services rendered rather than a distribution of earnings in excess of costs.

(2) Any change in an organization's compensation policy resulting in a substantial increase in the organization's level of compensation, particularly when it was concurrent with an increase in the ratio of Government awards to other activities of the organization or any change in the treatment of allowability of specific types of compensation due to changes in Government policy.

e. *Unallowable costs.* Costs which are unallowable under other paragraphs of this Attachment shall not be allowable under this paragraph solely on the basis that they constitute personal compensation.

f. *Fringe benefits.*

(1) Fringe benefits in the form of regular compensation paid to employees during periods of authorized absences from the job, such as vacation leave, sick leave, military leave, and the like, are allowable provided such costs are absorbed by all organization activities in proportion to the relative amount of time or effort actually devoted to each.

(2) Fringe benefits in the form of employer contributions or expenses for social security, employee insurance, workmen's compensation insurance, pension plan costs (see paragraph g. below), and the like, are allowable provided such benefits are granted in accordance with established written organization policies. Such benefits whether treated as indirect costs or as direct costs, shall be distributed to particular awards and other activities in a manner consistent with the pattern of benefits accruing to the individuals or group of employees whose salaries and wages are chargeable to such awards and other activities.

(3)(a) Provisions for a reserve under a self-insurance program for unemployment compensation or workers' compensation are allowable to the extent that the provisions represent reasonable estimates of the liabilities for such compensation, and the types of coverage, extent of coverage, and rates and premiums would have been allowable had insurance been purchased to cover the risks. However, provisions for self-insured liabilities which do not become payable for more than one year after the provision is made shall not exceed the present value of the liability.

(b) Where an organization follows a consistent policy of expensing actual payments to, or on behalf of, employees or former employees for unemployment compensation or workers' compensation, such payments are allowable in the year of payment with the prior approval of the awarding agency provided they are allocated to all activities of the organization.

(4) Costs of insurance on the lives of trustees, officers, or other employees holding positions of similar responsibility are allowable only to the extent that the insurance represents additional compensation. The costs of such insurance when the organization is named as beneficiary are unallowable.

g. *Pension plan costs.*

(1) Costs of the organization's pension plan which are incurred in accordance with the established policies of the organization are allowable, provided:

(a) Such policies meet the test of reasonableness;

(b) The methods of cost allocation are not discriminatory;

(c) The cost assigned to each fiscal year is determined in accordance with generally accepted accounting principles as prescribed in Accounting Principles Board Opinion No. 8 issued by the American Institute of Certified Public Accountants; and

(d) The costs assigned to a given fiscal year are funded for all plan participants within six months after the end of that year. However, increases to normal and past service pension costs caused by a delay in funding the actuarial liability beyond 30 days after each quarter of the year to which such costs are assignable are unallowable.

(2) Pension plan termination insurance premiums paid pursuant to the Employee Retirement Income Security Act of 1974 (Pub. L. 93–406) are allowable. Late payment charges on such premiums are unallowable.

(3) Excise taxes on accumulated funding deficiencies and other penalties imposed under the Employee Retirement Income Security Act are unallowable.

h. *Incentive compensation.* Incentive compensation to employees based on cost reduction, or efficient performance, suggestion awards, safety awards, etc., are allowable to the extent that the overall compensation is determined to be reasonable and such costs are paid or accrued pursuant to an agreement entered into in good faith between the organization and the employees before the services were rendered, or pursuant to an established plan followed by the organization so consistently as to imply, in effect, an agreement to make such payment.

i. *Overtime, extra pay shift, and multishift premiums.* See paragraph 27.

j. *Severance pay.* See paragraph 44.

k. *Training and education costs.* See paragraph 48.

l. *Support of salaries and wages.*

(1) Charges to awards for salaries and wages, whether treated as direct costs or indirect costs, will be based on documented payrolls approved by a responsible official(s) of the organization. The distribution of salaries and wages to awards must be supported by personnel activity reports as prescribed in subparagraph (2) below, except when a substitute system has been approved in writing by the the cognizant agency. (See paragraph E.2 of Attachment A)

(2) Reports reflecting the distribution of activity of each employee must be maintained for all staff members (professionals and nonprofessionals) whose compensation is charged, in whole or in part, directly to awards. In addition, in order to support the allocation of indirect costs, such reports must also be maintained for other employees whose work involves two or more funcitons or activities if a distribution of their compensation between such functions or activities is needed in the determination of the organization's indirect cost rate(s) (e.g., an employee engaged part-time in indirect cost activities and part-time in a direct function). Reports maintained by nonprofit organizations to satisfy these requirements must meet the following standards:

(a) The reports must reflect an *after-the-fact* determination of the actual activity of each employee. Budget estimates (i.e., estimates determined before the services are performed) do not qualify as support for charges to awards.

(b) Each report must account for the total activity for which employees are compensated and which is required in fulfillment of their obligations to the organization.

(c) The reports must be signed by the individual employee, or by a responsible supervisory official having first hand knowledge of the activities performed by the employee, that the distribution of activity represents a reasonable estimate of the actual work performed by the employee during the periods covered by the reports.

(d) The reports must be prepared at least monthly and must coincide with one or more pay periods.

(3) Charges for the salaries and wages of nonprofessional employees, in addition to the supporting documentation described in subparagraphs (1) and (2) above, must also be supported by records indicating the total number of hours worked each day maintained in conformance with Department of Labor regulations implementing the Fair Labor Standards Act (29 CFR Part 516). For this purpose, the term "nonprofessional employee" shall have the same meaning as "nonexempt employee," under the Fair Labor Standards Act.

(4) Salaries and wages of employees used in meeting cost sharing or matching requirements on awards must be supported in the same manner as salaries and wages claimed for reimbursement from awarding agencies.

7. *Contingency provisions.* Contributions to a contingency reserve or any similar provision made for events the occurrence of which cannot be foretold with certainty as to time, intensity, or with an assurance of their happening, are unallowable. The term "contingency reserve" excludes self-insurance reserves (see paragraph 6.f.(3) and 18.a.(2)(d)); pension funds (see paragraph 6.(g)); and reserves for normal severance pay (see paragraph 44.(b)(1).

8. *Contributions.* Contributions and donations by the organization to others are unallowable.

9. *Depreciation and use allowances.*

a. Compensation for the use of buildings, other capital improvements, and equipment on hand may be made through use allowances or depreciation. However, except as provided in paragraph f. below a combination of the two methods may not be used in connection with a single class of fixed assets (e.g., buildings, office equipment, computer equipment, etc.).

b. The computation of use allowances or depreciation shall be based on the acquisition cost of the assets involved. The acquisition cost of an asset donated to the organization by a third party shall be its fair market value at the time of the donation.

c. The computation of use allowances or depreciation will exclude.

(1) The cost of land;

(2) Any portion of the cost of buildings and equipment borne by or donated by the Federal Government irrespective of where title was originally vested or where it presently resides; and

(3) Any portion of the cost of buildings and equipment contributed by or for the organization in satisfaction of a statutory matching retirement.

d. Where the use allowance method is followed, the use allowance for buildings and improvement (including land improvements such as paved parking areas, fences, and sidewalks) will be computed at an annual rate not exceeding two percent of acquisition cost. The use allowance for equipment will be computed at an annual rate not exceeding six and two-thirds percent of acquisition cost. When the use allowance method is used for buildings, the entire building must be treated as a single asset; the building's components (e.g. plumbing system, heating and air conditioning, etc.) cannot be segregated from the building's shell. The two percent limitation, however, need not be applied to equipment which is merely attached or fastened to the building but not permanently fixed to it and which is used as furnishings or decorations or for specialized purposes (e.g., dentist chairs and dental treatment units, counters, laboratory benches bolted to the floor, dishwashers, carpeting, etc.). Such equipment will be considered as not being permanently fixed to the building if it can be removed without the need for costly or extensive alterations or repairs to the building or the equipment. Equipment that meets these criteria will be subject to the six and two-thirds percent equipment use allowance limitation.

e. Where depreciation method is followed, the period of useful service (useful life) established in each case for usable capital assets must take into consideration such factors as type of construction, nature of the equipment used, technological developments in the particular program area, and the renewal and replacement policies followed for the the individual items or classes of assets involved. The method of depreciation used to assign the cost of an asset (or group of assets) to accounting periods shall reflect the pattern of consumption of the asset during its useful life. In the absence of clear evidence indicating that the expected consumption of the asset will be significantly greater or lesser in the early portions of its

useful life than in the later portions, the straight-line method shall be presumed to be the appropriate method. Depreciation methods once used shall not be changed unless approved in advance by the cognizant Federal agency. When the depreciation method is introduced for application to assets previously subject to a use allowance, the combination of use allowances and depreciation applicable to such assets must not exceed the total acquisition cost of the assets. When the depreciation method is used for buildings, a building's shell may be segregated from each building component (e.g., plumbing system, heating, and air conditioning system, etc.) and each item depreciated over its estimated useful life; or the entire building (i.e., the shell and all components) may be treated as a single asset and depreciated over a single useful life.

f. When the depreciation method is used for a particular class of assets, no depreciation may be allowed on any such assets that, under paragraph e. above, would be viewed as fully depreciated. However, a reasonable use allowance may be negotiated for such assets if warranted after taking into consideration the amount of depreciation previously charged to the Government, the estimated useful life remaining at time of negotiation, the effect of any increased maintenance charges or decreased efficiency due to age, and any other factors pertinent to the utilization of the asset for the purpose contemplated.

g. Charges for use allowances or depreciation must be supported by adequate property records and physical inventories must be taken at least once every two years (a statistical sampling basis is acceptable) to ensure that assets exist and are usable and needed. When the depreciation method is followed, adequate depreciation records indicating the amount of depreciation taken each period must also be maintained.

10. *Donations*

a. *Services received.*

(1) Donated or volunteer services may be furnished to an organization by professional and technical personnel, consultants, and other skilled and unskilled labor. The value of these services is not reimbursable either as a direct or indirect cost.

(2) The value of donated services utilized in the performance of a direct cost activity shall be considered in the determination of the organization's indirect cost rate(s) and, accordingly, shall be allocated a proportionate share of applicable indirect costs when the following circumstances exist:

(a) The aggregate value of the services is material;

(b) The services are supported by a significant amount of the indirect costs incurred by the organization;

(c) The direct cost activity is not pursued primarily for the benefit of the Federal Government.

(3) In those instances where there is no basis for determining the fair market value of the services rendered, the recipient and the cognizant agency shall negotiate an appropriate allocation of indirect cost to the services.

(4) Where donated services directly benefit a project supported by an award, the indirect costs allocated to the services will be considered as a part of the total costs of the project. Such indirect costs may be reimbursed under the award or used to meet cost sharing or matching requirements.

(5) The value of the donated services may be used to meet cost sharing or matching requirements under conditions described in Attachment E, OMB Circular No. A-110. Where donated services are treated as indirect costs, indirect cost rates will separate the value of the donations so that reimbursement will not be made.

(6) Fair market value of donated services shall be computed as follows:

(a) *Rates for volunteer services.* Rates for volunteers shall be consistent with those regular rates paid for similar work in other activities of the organization. In cases where the kinds of skills involved are not found in the other activities of the organization, the rates used shall be consistent with those paid for similar work in the labor market in which the organization competes for such skills.

(b) *Services donated by other organizations.* When an employer donates the services of an employee, these services shall be valued at the employee's regular rate of pay (exclusive of fringe benefits and indirect costs) provided the services are in the same skill for which the employee is normally paid. If the services are not in the same skill for which the employee is normally paid, fair market value shall be computed in accordance with subparagraph (a) above.

b. *Goods and space.*

(1) Donated goods; i.e., expendable personal property/supplies, and donated use of space may be furnished to an organization. The value of the goods and space is not reimbursable either as a direct or indirect cost.

(2) The value of the donations may be used to meet cost sharing or matching share requirements under the conditions described in Attachment E, OMB Circular No. A-110. The value of the donations shall be determined in accordance with Attachment E. Where donations are treated as indirect costs, indirect cost rates will separate the value of the donations so that reimbursement will not be made.

11. *Employee morale, health, and welfare, costs and credits.* The costs of house publications, health or first-aid clinics, and/or infirmaries, recreational activities, employees' counseling services, and other expenses incurred in accordance with the organization's established practice or custom for the improvement of working conditions, employer-employee relations, employee morale, and employee performance are allowable. Such costs will be equitably apportioned to all activities of the organization. Income generated from any of these activities will be credited to the cost thereof unless such income has been irrevocably set over to employee welfare organizations.

12. *Entertainment costs.* Costs of amusement, diversion, social activities, ceremonials, and costs relating thereto, such as meals, lodging, rentals, transportation, and gratuities are unallowable (but see paragraphs 11 and 25).

13. *Equipment and other capital expenditures.*

a. As used in this paragraph, the following terms have the meanings set forth below:

(1) "Equipment" means an article of nonexpendable tangible personal property having a useful life of more than two years and an acquisition cost of $500 or more per unit. An organization may use its own definition provided that it at least includes all nonexpendable tangible personal property as defined herein.

(2) "Acquisition cost" means the net invoice unit price of an item of equipment, including the cost of any modifications, attachments, accessories, or auxiliary apparatus necessary to make it usable for the purpose for which it is acquired. Ancillary charges, such as taxes, duty, protective in-transit insurance, freight, and installation shall be included in or excluded from acquisition cost in accordance with the organization's regular written accounting practices.

(3) "Special purpose equipment" means equipment which is usable only for research, medical, scientific, or technical activities. Examples of special purpose equipment include microscopes, x-ray machines, surgical instruments, and spectrometers.

(4) "General purpose equipment" means equipment which is usable for other than research, medical, scientific, or technical activities, whether or not special modifications are needed to make them suitable for a particular purpose. Examples of general purpose equipment include office equipment and furnishings, air conditioning equipment, reproduction and printing equipment, motor vehicles, and automatic data processing equipment.

b. (1) Capital expenditures for general purpose equipment are unallowable as a direct cost except with the prior approval of the awarding agency.

(2) Capital expenditures for special purpose equipment are allowable as direct costs provided that items with a unit cost of $1000 or more have the prior approval of the awarding agency.

c. Capital expenditures for land or buildings are unallowable as a direct cost except with the prior approval of the awarding agency.

d. Capital expenditures for improvements to land, buildings, or equipment which materially increase their value or useful life are unallowable as a direct cost except with the prior approval of the awarding agency.

e. Equipment and other capital expenditures are unallowable as indirect costs. However, see paragraph 9 for allowability of use allowances or depreciation on buildings, capital improvements, and equipment. Also, see paragraph 42 for allowability of rental costs for land, buildings, and equipment.

14. *Fines and penalties.* Costs of fines and penalties resulting from violations of, or failure of the organization to comply with Federal, State, and local laws and regulations are unallowable except when incurred as a result of compliance with specific provisions of an award or instructions in writing from the awarding agency.

15. *Fringe benefits.* See paragraph 6. f.

16. *Idle facilities and idle capacity.*

a. As used in this paragraph the following terms have the meanings set forth below:

(1) "Facilities" means land and buildings or any portion thereof, equipment individually or collectively, or any other tangible capital asset, wherever located, and whether owned or leased by the organization.

(2) "Idle facilities" means completely unused facilities that are excess to the organization's current needs.

(3) "Idle capacity" means the unused capacity of partially used facilities. It is the difference between that which a facility could achieve under 100 per cent operating time on a one-shift basis less operating interruptions resulting from time lost for repairs, setups, unsatisfactory materials, and other normal delays, and the extent to which the facility was actually used to meet demands during the accounting period. A multishift basis may be used if it can be shown that this amount of usage could normally be expected for the type of facility involved.

(4) "Costs of idle facilities or idle capacity" means costs such as maintenance, repair, housing, rent, and other related costs; e.g., property taxes, insurance, and depreciation or use allowances.

b. The costs of idle facilities are unallowable except to the extent that:

(1) They are necessary to meet fluctuations in workload; or

(2) Although not necessary to meet fluctuations in workload, they were necessary when acquired and are now idle because of changes in program requirements, efforts to achieve more economical operations, reorganization, termination, or other causes which could not have been reasonably foreseen. Under the exception stated in this subparagraph, costs of idle facilities are allowable for a reasonable period of time, ordinarily not to exceed one year, depending upon the initiative taken to use, lease, or dispose of such facilities (but see paragraphs 47.c. and d.).

c. The costs of idle capacity are normal costs of doing business and are a factor in the normal fluctuations of usage or indirect cost rates from period to period. Such costs are allowable, provided the capacity is reasonably anticipated to be necessary or was originally reasonable and is not subject to reduction or elimination by subletting, renting, or sale, in accordance with sound business, economics, or security practices. Widespread idle capacity throughout an entire facility or among a group of assets having substantially the same function may be idle facilities.

17. *Independent research and development* [Reserved].

18. *Insurance and indemnification.*

a. Insurance includes insurance which the organization is required to carry, or which is approved, under the terms of the award and any other insurance which the organization maintains in connection with the general conduct of its operations. This paragraph does not apply to insurance which represents fringe benefits for employees (see paragraph 6.f. and 6.g.(2)).

(1) Costs of insurance required or approved, and maintained, pursuant to the award are allowable.

(2) Costs of other insurance maintained by the organization in connection with the general conduct of its operations are allowable subject to the following limitations.

(a) Types and extent of coverage shall be in accordance with sound business practice and the rates and premiums shall be reasonable under the circumstances.

(b) Costs allowed for business interruption or other similar insurance shall be limited to exclude coverage of management fees.

(c) Costs of insurance or of any provisions for a reserve covering the risk of loss or damage to Government property are allowable only to the extent that the organization is liable for such loss or damage.

(d) Provisions for a reserve under a self-insurance program are allowable to the extent that types of coverage, extent of coverage, rates, and premiums would have been allowed had insurance been purchased to cover the risks. However, provision for known or reasonably estimated self-insured liabilities, which do not become payable for more than one year after the provision is made shall not exceed the present value of the liability.

(e) Costs of insurance on the lives of trustees, officers, or other employees holding positions of similar responsibilities are allowable only to the extent that the insurance represents additional compensation (see paragraph 8). The cost of such insurance when the organization is identified as the beneficiary is unallowable.

(3) Actual losses which could have been covered by permissible insurance (through the purchase of insurance or a self-insurance program) are unallowable unless expressly provided for in the award, except:

(a) Costs incurred because of losses not covered under nominal deductible insurance coverage provided in keeping with sound business practice are allowable.

(b) Minor losses not covered by insurance, such as spoilage, breakage, and disappearance of supplies, which occur in the ordinary course of operations, are allowable.

b. Indemnification includes securing the organization against liabilities to third persons and any other loss or damage, not compensated by insurance or otherwise. The Government is obligated to indemnify the organization only to the extent expressly provided in the award.

19. *Interest, fund raising, and investment management costs.*

a. Costs incurred for interest on borrowed capital or temporary use of endowment funds, however represented, are unallowable.

b. Costs of organized fund raising, including financial campaigns, endowment drives, solicitation of gifts and bequests, and similar expenses incurred solely to raise capital or obtain contributions are unallowable.

c. Costs of investment counsel and staff and similar expenses incurred solely to enhance income from investments are unallowable.

d. Fund raising and investment activities shall be allocated an appropriate share of indirect costs under the conditions described in paragraph B of Attachment A.

20. *Labor relations costs.* Costs incurred in maintaining satisfactory relations between the organization and its employees, including costs of labor management committees, employee publications, and other related activities are allowable.

21. *Losses on other awards.* Any excess of costs over income on any award is unallowable as a cost of any other award. This includes, but is not limited to, the organization's contributed portion by reason of cost sharing agreements or any underrecoveries through negotiation of lump sums for, or ceilings on, indirect costs.

22. *Maintenance and repair costs.* Costs incurred for necessary maintenance, repair, or upkeep of buildings and equipment (including Government property unless otherwise provided for) which neither add to the permanent value of the property nor appreciably prolong its intended life, but keep it in an efficient operating condition, are allowable. Costs incurred for improvements which add to the permanent value of the buildings and equipment or appreciably prolong their intended life shall be treated as capital expenditures (see paragraph 15).

23. *Materials and supplies.* The costs of materials and supplies necessary to carry out an award are allowable. Such costs should be charged at their actual prices after deducting all cash discounts, trade discounts, rebates and allowances received by the organization. Withdrawals from general stores or stockrooms should be charged at cost under any recognized method of pricing consistently applied. Incoming transportation charges may be a proper part of material cost. Materials and supplies charged as a direct cost should include only the materials and supplies actually used for the performance of the contract or grant, and due credit should be given for any excess materials or supplies retained, or returned to vendors.

24. *Meetings, conferences.*

a. Costs associated with the conduct of meetings and conferences, include the cost of renting facilities, meals, speakers' fees, and the like. But see paragraph 12, *Entertainment costs*, and paragraph 29, *Participant support costs*.

b. To the extent that these costs are identifiable with a particular cost objective, they should be charged to that objective. (See paragraph B. of Attachment A.) These costs are allowable provided that they meet the general tests of allowability, shown in Attachment A to this Circular.

c. Costs of meetings and conferences held to conduct the general administration of the organization are allowable.

25. *Memberships, subscriptions, and professional activity costs.*

a. Costs of the organization's membership in civic, business, technical and professional organizations are allowable.

b. Costs of the organization's subscriptions to civic, business, professional, and technical periodicals are allowable.

c. Costs of attendance at meetings and conferences sponsored by others when the primary purpose is the dissemination of technical information, are allowable. This includes costs of meals, transportation, and other items incidental to such attendance.

26. *Organization costs.* Expenditures, such as incorporation fees, brokers' fees, fees to promoters, organizers or management consultants, attorneys, accountants, or

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investment counselors, whether or not employees of the organization, in connection with establishment or reorganization of an organization, are unallowable except with prior approval of the awarding agency.

27. *Overtime, extra-pay shift, and multishift premiums.* Premiums for overtime, extra-pay shifts, and multishift work are allowable only with the prior approval of the awarding agency except:

a. When necessary to cope with emergencies, such as those resulting from accidents, natural disasters, breakdowns of equipment, or occasional operational bottlenecks of a sporadic nature.

b. When employees are performing indirect functions such as administration, maintenance, or accounting.

c. In the performance of tests, laboratory procedures, or other similar operations which are continuous in nature and cannot reasonably be interrupted or otherwise completed.

d. When lower overall cost to the Government will result.

28. *Page charges in professional journals.* Page charges for professional journal publications are allowable as a necessary part of research costs, where:

a. The research papers report work supported by the Government; and

b. The charges are levied impartially on all research papers published by the journal, whether or not by Government-sponsored authors.

29. *Participant support costs.* Participant support costs are direct costs for items such as stipends or subsistence allowances, travel allowances, and registration fees paid to or on behalf of participants or trainees (but not employees) in connection with meetings, conferences, symposia, or training projects. These costs are allowable with the prior approval of the awarding agency.

30. *Patent costs.*

a. Costs of (i) preparing disclosures, reports, and other documents required by the award and of searching the art to the extend necessary to make such disclosures, (ii) preparing documents and any other patent costs in connection with the filing and prosecution of a United states patent application where title or royalty-free license is required by the Government to be conveyed to the Government, and (iii) general counseling services relating to patent and copyright matters, such as advice on patent and copyright laws, regulations, clauses, and employee agreements are allowable (but see paragraph 34).

b. Cost of preparing disclosures, reports, and other documents and of searching the art to the extent necessary to make disclosures, if not required by the award, are unallowable. Costs in connection with (i) filing and prosecuting any foreign patent application, or (ii) any United States patent application, where the award does not require conveying title or a royalty-free license to the Government, are unallowable (also see paragraph 43).

31. *Pension plans.* See paragraph 6. g.

32. *Plant security costs.* Necessary expenses incurred to comply with Government security requirements or for facilities protection, including wages, uniforms, and equipment of personnel are allowable.

33. *Preaward costs.* Preaward costs are those incurred prior to the effective date of the award directly pursuant to the negotiation and in anticipation of the award where such costs is necessary to comply with the proposed delivery schedule or period of performance. Such costs are allowable only to the extent that they would have been allowable if incurred after the date of the award and only with the written approval of the awarding agency.

34. *Professional service costs.*

a. Costs of professional and consultant services rendered by persons who are members of a particular profession or possess a special skill, and who are not officers or employees of the organization, are allowable, subject to b, c, and d, of this paragraph when reasonable in relation to the services rendered and when not contingent upon recovery of the costs from the Government.

b. In determing the allowability of costs in a particular case, no single factor or any special combination of factors is necessarily determinative. However, the following factors are relevant:

(1) The nature and scope of the service rendered in relation to the service required.

(2) The necessity of contracting for the service, considering the organization's capability in the particular area.

(3) The past pattern of such costs, particularly in the years prior to Government awards.

(4) The impact of Government awards on the organization's business (i.e., what new problems have arisen).

(5) Whether the proportion of Government work to the organization's total business is such as to influence the organization in favor of incurring the cost, particularly where the services rendered are not of a continuing nature and have little relationship to work under Government grants and contracts.

(6) Whether the service can be performed more economically by direct employment rather than contracting.

(7) The qualifications of the individual or concern rendering the service and the customary fees charged, especially on non-Government awards.

(8) Adequacy of the contractual agreement for the service (e.g., description of the service, estimate of time required, rate of compensation, and termination provisions).

c. In addition to the factors in paragraph b above, retainer fees to be allowable must be supported by evidence of bona fide services available or rendered.

d. Cost of legal, accounting, and consulting services, and related costs incurred in connection with defense of antitrust suits, and the prosecution of claims against the Government, are unallowable. Costs of legal, accounting and consulting services, and related costs, incurred in connection with patent infringement litigation, organization and reorganization, are unallowable unless otherwise provided for in the award (but see paragraph 47e).

35. *Profits and losses on disposition of depreciable property or other capital assets.*

a. (1) Gains and losses on sale, retirement, or other disposition of depreciable property shall be included in the year in which they occur as credits or charges to cost grouping(s) in which the depreciation applicable to such property was included. The amount of the gain or loss to be included as a credit or charge to the appropriate cost grouping(s) shall be the difference between the amount realized on the property and the undepreciated basis of the property.

(2) Gains and losses on the disposition of depreciable property shall not be recognized as a separate credit or charge under the following conditions.

(a) The gain or loss is processed through a depreciation reserve account and is reflected in the depreciation allowable under paragraph 9.

(b) The property is given in exchange as part of the purchase price of a similar item and the gain or loss is taken into account in determining the depreciation cost basis of the new item.

(c) A loss results from the failure to maintain permissible insurance, except as otherwise provided in paragraph 18.a.(3).

(d) Compensation for the use of the property was provided through use allowances in lieu of depreciation in accordance with paragraph 9.

(e) Gains and losses arising from mass or extraordinary sales, retirements, or other dispositions shall be considered on a case-by-case basis.

b. Gains or losses of any nature arising from the sale or exchange of property other than the property covered in paragraph a. above shall be excluded in computing award costs.

36. *Public information service costs.*

a. Public information service costs include the cost associated with pamphlets, news releases, and other forms of information services. Such costs are normally incurred to:

(1) Inform or instruct individuals, groups, or the general public.

(2) Interest individuals or groups in participating in a service program of the organization.

(3) Disseminate the results of sponsored and nonsponsored activities.

b. Public information service costs are allowable as direct costs with the prior approval of the awarding agency. Such costs are unallowable as indirect costs.

37. *Publication and printing costs.*

a. Publication costs include the costs of printing (including the processes of composition, plate-making, press work, binding, and the end products produced by such processes), distribution, promotion, mailing, and general handling.

b. If these costs are not identifiable with a particular cost objective, they should be allocated as indirect costs to all benefiting activities of the organization.

c. Publication and printing costs are unallowable as direct costs except with the prior approval of the awarding agency.

d. The cost of page charges in journals is addressed paragraph 28.

38 *Rearrangement and alteration costs.* Costs incurred for ordinary or normal rearrangement and alteration of facilities are allowable. Special arrangement and alteration costs incurred specifically for the project are allowable with the prior approval of the awarding agency.

39 *Reconversion costs.* Costs incurred in the restoration or rehabilitation of the organization's facilities to approximately the same condition existing immediately prior to commencement of Government awards, fair wear and tear excepted, are allowable.

40. *Recruiting costs.* The following recruiting costs are allowable: cost of "help wanted" advertising, operating costs of an employment office, costs of operating an educational testing program, travel expenses including food and lodging of employees while engaged in recruiting personnel, travel costs of applicants for interviews for prospective employment, and relocation costs incurred incident to recruitment of new employees (see paragraph 41c). Where the organization uses employment agencies, costs not in excess of standard commercial rates for such services are allowable.

41. *Relocation costs.*

a. Relocation costs are costs incident to the permanent change of duty assignment (for an indefinite period or for a stated period of not less than 12 months) of an existing employee or upon recruitment of a new employee. Relocation costs are allowable, subject to the limitation described in paragraphs b, c, and d, below, provided that:

(1) The move is for the benefit of the employer.

(2) Reimbursement to the employee is in accordance with an established written policy consistently followed by the employer.

(3) The reimbursement does not exceed the employee's actual (or reasonably estimated) expenses.

b. Allowable relocation costs for current employees are limited to the following:

(1) The costs of transportation of the employee, members of his immediate family and his household, and personal effects to the new location.

(2) The costs of finding a new home, such as advance trips by employees and spouses to locate living quarters and temporary lodging during the transition period, up to a maximum period of 30 days, including advance trip time.

(3) Closing costs, such as brokerage, legal, and appraisal fees, incident to the disposition of the employee's former home. These costs, together with those described in (4) below, are limited to 8 per cent of the sales price of the employee's former home.

(4) The continuing costs of ownership of the vacant former home after the settlement or lease date of the employee's new permanent home, such as maintenance of buildings and grounds (exclusive of fixing up expenses), utilities, taxes, and property insurance.

(5) Other necessary and reasonable expenses normally incident to relocation, such as the costs of cancelling an unexpired lease, disconnecting and reinstalling household appliances, and purchasing insurance against loss of or damages to personal property. The cost of cancelling an unexpired lease is limited to three times the monthly rental.

c. Allowable relocation costs for new employees are limited to those described in (1) and (2) of paragraph b. above. When relocation costs incurred incident to the recruitment of new employees have been allowed either as a direct or indirect cost and the employee resigns for reasons within his control within 12 months after hire, the organization shall refund or credit the Government for its share of the cost. However, the costs of travel to an overseas location shall be considered travel costs in accordance with paragraph 50 and not relocation costs for the purpose of this paragraph if dependents are not permitted at the location for any reason and the costs do not include costs of transporting household goods.

d. The following costs related to relocation are unallowable:

(1) Fees and other costs associated with acquiring a new home.

(2) A loss on the sale of a former home.

(3) Continuing mortgage principal and interest payments on a home being sold.

(4) Income taxes paid by an employee related to reimbursed relocation costs.

42. *Rental costs.*

a. Subject to the limitations described in paragraphs b. through d. of this paragraph, rental costs are allowable to the extent that the rates are reasonable in light of such factors as: rental costs of comparable property, if any; market conditions in the area; alternatives available; and the type, life expectancy, condition, and value of the property leased.

b. Rental costs under sale and leaseback arrangements are allowable only up to the amount that would be allowed had the organization continued to own the property.

c. Rental costs under less-than-length leases are allowable only up to the amount that would be allowed had title to the property vested in the organization. For this purpose, a less-than-arms-length lease is one under which one party to the lease agreement is able to control or substantially influence the actions of the other. Such leases include, but are not limited to those between (i) divisions of an organization; (ii) organizations under common control through common officers, directors, or members; and (iii) an organization and a director, trustee, officer, or key employee of the organization or his immediate family either directly or through corporations, trusts, or similar arrangements in which they hold a controlling interest.

d. Rental costs under leases which create a material equity in the leased property are allowable only up to the amount that would be allowed had the organization purchased the property on the date the lease agreement was executed; e.g., depreciation or use allowances, maintenance, taxes, insurance but excluding interest expense and other unallowable costs. For this purpose, a material equity in the property exists if the lease in noncancelable or is cancelable only upon the occurrence of some remote contingency and has one or more of the following characteristics:

(1) The organization has the right to purchase the property for a price which at the beginning of the lease appears to be substantially less than the probable fair market value at the time it is permitted to purchase the property (commonly called a lease with a bargain purchase option);

(2) Title to the property passes to the organization at some time during or after the lease period;

(3) The term of the lease (initial term plus periods covered by bargain renewal options, if any) is equal to 75 per cent or more of the economic life of the leased property; i.e., the period the property is expected to be economically usable by one or more users.

43. *Royalties and other costs for use of patents and copyrights.*

a. Royalties on a patent or copyright or amortization of the cost of acquiring by purchase a copyright, patent, or rights thereto, necessary for the proper performance of the award are allowable unless:

(1) The Government has a license or the right to free use of the patent or copyright.

(2) The patent or copyright has been adjudicated to be invalid, or has been administratively determined to be invalid.

(3) The patent or copyright is considered to be unenforceable.

(4) The patent or copyright is expired.

b. Special care should be exercised in determining reasonableness where the royalties may have been arrived at as a result of less then arm's length bargaining; e.g.:

(1) Royalties paid to persons, including corporations, affiliated with the organization.

(2) Royalties paid to unaffiliated parties, including corporations, under an agreement entered into in contemplation that a Government award would be made.

(3) Royalties paid under an agreement entered into after an award is made to an organization.

c. In any case involving a patent or copyright formerly owned by the organization, the amount of royalty allowed should not exceed the cost which would have been allowed had the organization retained title thereto.

44. *Severance pay.*

a. Severance pay, also commonly referred to as dismissal wages, is a payment in addition to regular salaries and wages, by organizations to workers whose employment is being terminated. Costs of severance pay are allowable only to the extent that in each case, it is required by (i) law, (ii) employer-employee agreement, (iii) established policy that constitutes, in effect, an implied agreement on the organization's part, or (iv) circumstances of the particular employment.

b. Costs of severance payments are divided into two categories as follows:

(1) Actual normal turnover severance payments shall be allocated to all activities; or, where the organization provides for a reserve for normal severances such method will be acceptable if the charge to current operations is reasonable in light of payments actually made for normal severances over a representative past period, and if amounts charged are allocated to all activities of the organization.

(2) Abnormal or mass severance pay is of such a conjectural nature that measurement of costs by means of an accrual will not achieve equity to both parties. Thus, accruals for this purpose are not allowable. However, the Government recognizes its obligation to participate to the extent of its fair share, in any specific payment. Thus, allowability will be considered on a case-by-case basis in the event of occurrence.

45. *Specialized service facilities.*

a. The costs of services provided by highly complex or specialized facilities operated by

curriculum, which are allowable only to the extent set forth in b. and c. above.

e. Maintenance expense, and normal depreciation or fair rental, on facilities owned or leased by the organization for training purposes are allowable to the extent set forth in paragraphs 9, 22, and 42.

f. Contributions or donations to educational or training institutions, including the donation of facilities or other properties, and scholarships or fellowships, are unallowable.

g. Training and education costs in excess of those otherwise allowable under paragraphs b. and c. of this paragraph may be allowed with prior approval of the awarding agency. To be considered for approval, the organization must demonstrate that such costs are consistently incurred pursuant to an established training and education program, and that the course or degree pursued is relative to the field in which the employee is now working or may reasonably be expected to work.

49. *Transportation costs.* Transportation costs include freight, express, cartage, and postage charges relating either to goods purchased, in process, or delivered. These costs are allowable. When such costs can readily be identified with the items involved, they may be directly charged as transportation costs or added to the cost of such items (see paragraph 23). Where identification with the materials received cannot readily be made, transportation costs may be charged to the appropriate indirect cost accounts if the organization follows a consistent, equitable procedure in this respect.

50. *Travel costs.*

a. Travel costs are the expenses for transportation, lodging, subsistence, and related items incurred by employees who are in travel status on official business of the organization. Travel costs are allowable subject to paragraphs b. through e. below, when they are directly attributable to specific work under an award or are incurred in the normal course of administration of the organization.

b. Such costs may be charged on an actual basis, on a per diem or mileage basis in lieu of actual costs incurred, or on a combination of the two, provided the method used results in charges consistent with those normally allowed by the organization in its regular operations.

c. The difference in cost between first-class air accommodations and less than first-class air accommodations is unallowable except when less than first-class air accommodations are not reasonably available to meet necessary mission requirements, such as where less than first-class accommodations would (i) require circuitous routing, (ii) require travel during unreasonable hours, (iii) greatly increase the duration of the flight, (iv) result in additional costs which would offset the transportation savings, or (v) offer accommodations which are not reasonably adequate for the medical needs of the traveler.

d. Necessary and reasonable costs of family movements and personnel movements of a special or mass nature are allowable, pursuant to paragraphs 40 and 41, subject to allocation on the basis of work or time period benefited when appropriate. Advance agreements are particularly important.

e. Direct charges for foreign travel costs are allowable only when the travel has received prior approval of the awarding agency. Each separate foreign trip must be approved. For purposes of this provision, foreign travel is defined as any travel outside of Canada and the United States and its territories and possessions. However, for an organization located in foreign countries, the term "foreign travel" means travel outside that country.

[Circular No. A-122]

Attachment C

Nonprofit Organizations not Subject to this Circular

Aerospace Corporation, El Segundo, California
Argonne Universities Association, Chicago, Illinois
Associated Universities, Incorporated, Washington, D.C.
Associated Universities for Research and Astronomy, Tucson, Arizona
Atomic Casualty Commission, Washington, D.C.
Battelle Memorial Institute, Headquartered in Columbus, Ohio
Brookhaven National Laboratory, Upton, New York
Center for Energy and Environmental Research (CEER), (University of Puerto Rico) Commonwealth of Puerto Rico
Charles Stark Draper Laboratory, Incorporated, Cambridge, Massachusetts
Comparative Animal Research Laboratory (CARL)
(University of Tennessee), Oak Ridge, Tennessee
Environmental Institute of Michigan, Ann Arbor, Michigan
Hanford Environmental Health Foundation, Richland, Washington
IIT Research Institute, Chicago, Illinois
Institute for Defense Analysis, Arlington, Virginia
Institute of Gas Technology, Chicago, Illinois
Midwest Research Institute, Headquartered in Kansas City, Missouri
Mitre Corporation, Bedford, Massachusetts
Montana Energy Research and Development Institute, Inc., (MERDI), Butte, Montana
National Radiological Astronomy Observatory, Green Bank, West Virginia
Oak Ridge Associated Universities, Oak Ridge, Tennessee
Project Management Corporation, Oak Ridge, Tennessee
Rand Corporation, Santa Monica, California
Research Triangle Institute, Research Triangle Park, North Carolina
Riverside Research Institute, New York, New York
Sandia Corporation, Albuquerque, New Mexico
Southern Research Institute, Birmingham, Alabama
Southwest Research Institute, San Antonio, Texas
SRI International, Menlo Park, California
Syracuse Research Corporation, Syracuse, New York
Universities Research Association, Incorporated (National Acceleration Lab), Argonne, Illinois
Universities Corporation for Atmospheric Research, Boulder, Colorado
Nonprofit Insurance Companies such as Blue Cross and Blue Shield Organizations
Other nonprofit organizations as negotiated with awarding agencies.

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the organization, such as electronic computers and wind tunnels, are allowable provided the charges for the services meet the conditions of either b. or c. of this paragraph and, in addition, take into account any items of income or Federal financing that qualify as applicable credits under paragraph A.5. of Attachment A.

b. The costs of such services, when material, must be charged directly to applicable awards based on actual usage of the services on the basis of a schedule of rates or established methodology that (i) does not discriminate against federally supported activities of the organization, including usage by the organization for internal purposes, and (ii) is designed to recover only the aggregate costs of the services. The costs of each service shall consist normally of both its direct costs and its allocable share of all indirect costs. Advance agreements pursuant to paragraph A.6. of Attachment A are particularly important in this situation.

c. Where the costs incurred for a service are not material, they may be allocated as indirect costs.

46. *Taxes.*

a. In general, taxes which the organization is required to pay and which are paid or accrued in accordance with generally accepted accounting principles, and payments made to local governments in lieu of taxes which are commensurate with the local government services received are allowable, except for (i) taxes from which exemptions are available to the organization directly or which are available to the organization based on an exemption afforded the Government and in the latter case when the awarding agency makes available the necessary exemption certificates, (ii) special assessments on land which represent capital improvements, and (iii) Federal income taxes.

b. Any refund of taxes, and any payment to the organization of interest thereon, which were allowed as award costs, will be credited either as a cost reduction or cash refund, as appropriate, to the Government.

47. *Termination costs.* Termination of awards generally give rise to the incurrence of costs, or the need for special treatment of costs, which would not have arisen had the award not been terminated. Cost principles covering these items are set forth below. They are to be used in conjunction with the other provisions of this Circular in termination situations.

a. *Common items.* The cost of items reasonably usable on the organization's other work shall not be allowable unless the organization submits evidence that it would not retain such items at cost without sustaining a loss. In deciding whether such items are reasonably usable on other work of the organization, the awarding agency should consider the organization's plans and orders for current and scheduled activity. Contemporaneous purchases of common items by the organization shall be regarded as evidence that such items are reasonably usable on the organization's other work. Any acceptance of common items as allocable to the terminated portion of the award shall be limited to the extent that the quantities of such items on hand, in transit, and on order are in excess of the reasonable quantitative requirements of other work.

b. *Costs continuing after termination.* If in a particular case, despite all reasonable efforts by the organization, certain costs cannot be discontinued immediately after the effective date of termination, such costs are generally allowable within the limitations set forth in this Circular, except that any such costs continuing after termination due to the negligent or willful failure of the organization to discontinue such costs shall be unallowable.

c. *Loss of useful value.* Loss of useful value of special tooling, machinery and equipment which was not charged to the award as a capital expenditure is generally allowable if:

(1) Such special tooling, machinery, or equipment is not reasonably capable of use in the other work of the organization.

(2) The interest of the Government is protected by transfer of title or by other means deemed appropriate by the awarding agency;

d. *Rental costs.* Rental costs under unexpired leases are generally allowable where clearly shown to have been reasonably necessary for the performance of the terminated award less the residual value of such leases, if (i) the amount of such rental claimed does not exceed the reasonable use value of the property leased for the period of the award and such further period as may be reasonable, and (ii) the organization makes all reasonable efforts to terminate, assign, settle, or otherwise reduce the cost of such lease. There also may be included the cost of alterations of such leased property, provided such alterations were necessary for the performance of the award, and of reasonable restoration required by the provisions of the lease.

e. *Settlement expenses.* Settlement expenses including the following are generally allowable:

(1) Accounting, legal, clerical, and similar costs reasonably necessary for:

(a) The preparation and presentation to awarding agency of settlement claims and supporting data with respect to the terminated portion of the award, unless the termination is for default. (See paragraph 4.a. of Attachment L, OMB Circular No. A-110; and

(b) The termination and settlement of subawards.

(2) Reasonable costs for the storage, transportation, protection, and disposition of property provided by the Government or acquired or produced for the award; except when grantees are reimbursed for disposals at a predetermined amount in accordance with Attachment N of OMB Circular A-110.

(3) Indirect costs related to salaries and wages incurred as settlement expenses in subparagraphs (1) and (2) of this paragraph. Normally, such indirect costs shall be limited to fringe benefits, occupancy cost, and immediate supervision.

f. *Claims under subawards.* Claims under subawards, including the allocable portion of claims which are common to the award, and to other work of the organization are generally allowable. An appropriate share of the organization's indirect expense may be allocated to the amount of settlements with subcontractor/subgrantees; provided that the amount allocated is otherwise consistent with the basic guidelines contained in Attachment A. The indirect expense so allocated shall exclude the same and similar costs claimed directly or indirectly as settlement expenses.

48. *Training and education costs.*

a. Costs of preparation and maintenance of a program of instruction including but not limited to on-the-job, classroom, and apprenticeship training, designed to increase the vocational effectiveness of employees, including training materials, textbooks, salaries or wages of trainees (excluding overtime compensation which might arise therefrom), and (i) salaries of the director of training and staff when the training program is conducted by the organization; or (ii) tuition and fees when the training is in an institution not operated by the organization, are allowable.

b. Costs of part-time education, at an undergraduate or postgraduate college level, including that provided at the organization's own facilities, are allowable only when the course or degree pursued is relative to the field in which the employee is now working or may reasonably be expected to work, and are limited to:

(1) Training materials.

(2) Textbooks.

(3) Fees charges by the educational institution.

(4) Tuition charged by the educational institution, or in lieu of tuition, instructors' salaries and the related share of indirect costs of the educational institution to the extent that the sum thereof is not in excess of the tuition which would have ben paid to the participating educational institution.

(5) Salaries and related costs of instructors who are employees of the organization.

(6) Straight-time compensation of each employee for time spent attending classes during working hours not in excess of 156 hours per year and only to the extent that circumstances do not permit the operation of classes or attendance at classes after regular working hours; otherwise such compensation is unallowable.

c. Costs of tuition, fees, training materials, and textbooks (but not subsistence, salary, or any other emoluments) in connection with full-time education, including that provided at the organization's own facilities, at a postgraduate (but not undergraduate) college level, are allowable only when the course or degree pursued is related to the field in which the employee is now working or may reasonably be expected to work, and only where the costs receive the prior approval of the awarding agency. Such costs are limited to the costs attributable to a total period not to exceed one school year for each employee so trained. In unusual cases the period may be extended.

d. Costs of attendance of up to 16 weeks per employee per year at specialized programs specifically designed to enhance the effectiveness of executives or managers or to prepare employees for such positions are allowable. Such costs include enrollment fees, training materials, textbooks and related charges, employees' salaries, subsistence, and travel. Costs allowable under this paragraph do not include those for courses that are part of a degree-oriented

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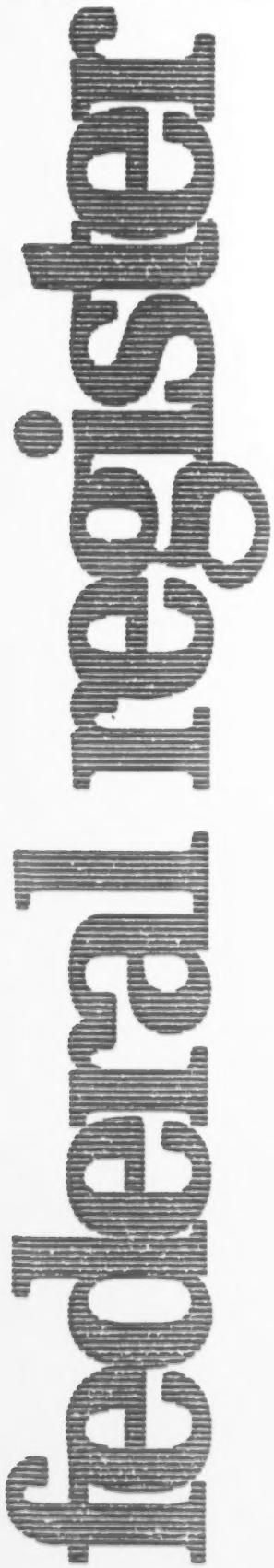

Friday
April 27, 1984

Part VII

Office of Management and Budget

Circular A-122: Cost Principles for Nonprofit Organizations; "Lobbying" Revision

Department of Defense
General Services Administration
National Aeronautics and Space Administration

48 CFR Part 31
Federal Acquisition Regulation; Final Rule

1. Insert a new paragraph in attachment B, as follows: "B21 Lobbying"

a. Notwithstanding other provisions of this Circular, costs associated with the following activities are unallowable:

a.(1) Attempts to influence the outcomes of any Federal, State, or local election, referendum, initiative, or similar procedure, through in kind or cash contributions, endorsements, publicity, or similar activity;

a.(2) Establishing, administering, contributing to, or paying the expenses of a political party, campaign, political action committee, or other organization established for the purpose of influencing the outcomes of elections;

a.(3) Any attempt to influence: (i) The introduction of Federal or state legislation; or (ii) the enactment or modification of any pending Federal or state legislation through communication with any member or employee of the Congress or state legislature (including efforts to influence State or local officials to engage in similar lobbying activity), or with any government official or employee in connection with a decision to sign or veto enrolled legislation;

a.(4) Any attempt to influence: (i) The introduction of Federal or state legislation; or (ii) the enactment or modification of any pending Federal or state legislation by preparing, distributing or using publicity or propaganda, or by urging members of the general public or any segment thereof to contribute to or participate in any mass demonstration, march, rally, fundraising drive, lobbying campaign or letter writing or telephone campaign; or

a.(5) Legislative liaison activities, including attendance at legislative sessions or committee hearings, gathering information regarding legislation, and analyzing the effect of legislation, when such activities are carried on in support of or in knowing preparation for an effort to engage in unallowable lobbying.

b. The following activities are excepted from the coverage of subparagraph a:

b.(1) Providing a technical and factual presentation of information on a topic directly related to the performance of a grant, contract or other agreement through hearing testimony, statements or letters to the Congress or a state legislature, or subdivision, member, or cognizant staff member thereof, in response to a documented request (including a Congressional Record notice requesting testimony or statements for the record at a regularly scheduled hearing) made by the recipient member, legislative body or subdivision, or a cognizant staff member thereof; provided such information is readily obtainable and can be readily put in deliverable form; and further provided that costs under this section for travel, lodging or meals are unallowable unless incurred to offer testimony at a regularly scheduled Congressional hearing pursuant to a written request for such presentation made by the Chairman or Ranking Minority Member of the Committee or Subcommittee conducting such hearing.

b.(2) Any lobbying made unallowable by section a.(3) to influence State legislation in order to directly reduce the cost, or to avoid material impairment of the organization's authority to perform the grant, contract, or other agreement.

b.(3) Any activity specifically authorized by statute to be undertaken with funds from the grant, contract, or other agreement.

c.(1) When an organization seeks reimbursement for indirect costs, total lobbying costs shall be separately identified in the indirect cost rate proposal, and thereafter treated as other unallowable activity costs in accordance with the procedures of paragraph B3 of Attachment A.

c.(2) Organizations shall submit as part of their annual indirect cost rate proposal a certification that the requirements and standards of this paragraph have been complied with.

c.(3) Organizations shall maintain adequate records to demonstrate that the determination of costs as being allowable or unallowable pursuant to paragraph B21 complies with the requirements of this Circular.

c.(4) Time logs, calendars, or similar records documenting the portion of an employee's time that is treated as an indirect cost shall not be required for the purposes of complying with subparagraph c, and the absence of such records which are not kept pursuant to the discretion of the grantee or contractor, will not serve as a basis for disallowing claims of allowable costs by contesting estimates of unallowable lobbying time spent by employees during any calendar month unless: (i) The employee engages in lobbying, as defined in subparagraphs a and b, more than 25% of his compensated hours of employment during that calendar month; or (ii) the organization has materially misstated allowable or unallowable costs within the preceding five year period.

c.(5) Agencies shall establish procedures for resolving in advance, in consultation with OMB, any significant questions or disagreements concerning the interpretation or application of paragraph B21. Any such advance resolution shall be binding in any subsequent settlements, audits or investigations with respect to that grant or contract for purposes of interpretation of this Circular; provided, however, that this shall not be construed to prevent a contractor or grantee from contesting the lawfulness of such a determination.

2. Renumber subsequent paragraphs of Attachment B.

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Appendix E to 45 CFR Part 74

Appendix A — [Reserved]
Appendix B — [Reserved]
Appendix C — [Reserved]
Appendix D — [Reserved]

APPENDIX E—PRINCIPLES FOR DETERMINING COSTS APPLICABLE TO RESEARCH AND DEVELOPMENT UNDER GRANTS AND CONTRACTS WITH HOSPITALS

I. Purpose and scope

A. *Objectives.* This appendix provides principles for determining the costs applicable to research and development work performed by hospitals under grants and contracts with the U.S. Department of Health and Human Services. These principles are confined to the subject of cost determination and make no attempt to identify the circumstances or dictate the extent of hospital participation in the financing of a particular research or development project. The principles are designed to provide recognition of the full allocated costs of such research work under generally accepted accounting principles. These principles will be applicable to both proprietary and non-profit hospitals. No proision for profit or other increment above cost is provided for in these principles. However, this is not to be interpreted as precluding a negotiated fee between contracting parties when a fee is appropriate.

B. *Policy guides.* The successful application of these principles requires development of mutual understanding between representatives of hospitals and of the Department of Health and Human Services as to their scope, applicability and interpretation. It is recognized that:

1. The arrangements for hospital participation in the financing of a research and development project are properly subject to negotiation between the agency and the hospital concerned in accordance with such Government-wide criteria as may be applicable.

2. Each hospital, possessing its own unique combination of staff, facilities and experience, should be encouraged to conduct research in a manner consonant with its own institutional philosophies and objectives.

3. Each hospital in the fulfillment of its contractual obligations should be expected to employ sound management practices.

4. The application of the principles established herein shall be in conformance with the generally accepted accounting practices of hospitals.

5. Hospitals receive reimbursements from the Federal Government for differing types of services under various programs such as support of Research and Development (including discrete clinical centers) Health Services Projects, Medicare, etc. It is essential that consistent procedures for determining reimbursable costs for similar services be employed without regard to program differences. Therefore, both the direct and indirect costs of research programs must be identified as a cost center(s) for the cost finding and step-down requirements of the Medicare program, or in its absence the Medicaid program.

C. *Application.* All operating agencies within the Department of Health and Human Services that sponsor research and development work in hospitals will apply these principles and related policy guides in determining the costs incurred for such work under grants and cost-reimbursement type contracts and subcontracts. These principles will also be used as a guide in the pricing of fixed price contracts and subcontracts.

II. Definitions of terms

A. "Organized research" means all research activities of a hospital that may be identified whether the support for such research is from a federal, non-federal or internal source.

B. "Departmental research" means research activities that are not separately budgeted and accounted for. Such work, which includes all research activities not encompassed under the term organized research, is regarded for purposes of this document as a part of the patient care activities of the hospital.

C. "Research agreement" means any valid arrangement to perform federally-sponsored research or development including grants, cost-reimbursement type contracts, cost-reimbursement type sub-contracts, and fixed-price contracts and sub-contracts.

D. "Instruction and training" means the formal or informal programs of educating and training technical and professional health services personnel, primarily medical and nursing training. This activity, if separately budgeted or identifiable with specific costs, should be

considered as a cost objective for purposes of indirect cost allocations and the development of patient care costs.

E. "Other hospital activities" means all organized activities of a hospital not immediately related to the patient care, research, and instructional and training functions which produce identifiable revenue from the performance of these activities. If a non-related activity does not produce identifiable revenue, it may be necessary to allocate this expense using an appropriate basis. In such a case, the activity may be included as an allocable cost (See para. III D below.) Also included under this definition is any category of cost treated as "Unallowable," provided such category of cost identifies a function or activity to which a portion of the institution's indirect cost (as defined in para. V. A.) are properly allocable.

F. "Patient care" means those departments or cost centers which render routine or ancillary services to in-patients and/or outpatients. As used in para. IX B.23, it means the cost of these services applicable to patients involved in research programs.

G. "Allocation" means the process by which the indirect costs are assigned as between:

1. Organized research,
2. Patient care including departmental research,
3. Instruction and training, and
4. Other hospital activities.

H. "Cost center" means an identifiable department or area (including research) within the hospital which has been assigned an account number in the hospital accounting system for the purpose of accumulating expense by department or area.

I. "Cost finding" is the process of recasting the date derived from the accounts ordinarily kept by a hospital to ascertain costs of the various types of services rendered. It is the determination of direct costs by specific identification and the proration of indirect costs by allocation.

J. "Step down" is a cost finding method that recognizes that services rendered by certain nonrevenue-producing departments or centers are utilized by certain other nonrevenue producing centers as well as by the revenue-producing centers. All costs of nonrevenue-producing centers are allocated to all centers which they serve, regardless of whether or not these centers produce revenue. Following the apportionment of the cost of the nonrevenue-producing center, that center will be considered closed and no further costs are apportioned to that center.

K. "Scatter bed" is a bed assigned to a research patient based on availability. Research patients occupying these beds are not physically segregated from nonresearch patients occupying beds. Scatter beds are geographically dispersed among all the beds available for use in the hospital. There are no special features attendant to a scatter bed that distinguishes it from others that could just as well have been occupied.

L. "Discrete bed" is a bed or beds that have been set aside for occupancy by research patients and are physically segregated from other hospital beds in an environment that permits an easily ascertainable allocation of costs associated with the space they occupy and the services they generate.

III. Basic considerations

A. *Composition of total costs.* The cost of a research agreement is comprised of the allowable direct costs incident to its performance plus the allocable portion of the allowable indirect costs of the hospital less applicable credits. (See para. III-E.)

B. *Factors affecting allowability of costs.* The tests of allowability of costs under these principles are:

1. They must be reasonable,
2. They must be assigned to research agreements under the standards and methods provided herein,
3. They must be accorded consistent treatment through application of those generally accepted accounting principles appropriate to the circumstances (See para. I-B.5.) and
4. They must conform to any limitations or exclusions set forth in these principles or in the research agreement as to types or amounts of cost items.

C. *Reasonable costs.* A cost may be considered reasonable if the nature of the goods or services acquired or applied, and the amount involved therefor reflect the action that a prudent person would have taken under the circumstances prevailing at the time the decision to incur the cost was made. Major considerations involved in the determination of the reasonableness of a cost are:

1. Whether or not the cost is of a type generally recognized as necessary for the operation of the hospital or the performance of the research agreement,
2. The restraints or requirements imposed by such factors as arm's length bargaining, federal and state laws and regulations, and research agreement terms and conditions,
3. Whether or not the individuals concerned acted with due prudence in the circumstances, considering their responsibilities to the hospital, its patients, its employees, its students, the Government, and the public at large, and
4. The extent to which the actions taken with respect to the incurrence of the cost are consistent with established hospital policies and practices applicable to the work of the hospital generally, including Government research.

D. *Allocable costs.* 1. A cost is allocable to a particular cost center (i.e., a specific function, project, research agreement, department, or the like) if the goods or services involved are chargeable or assignable

to such cost center in accordance with relative benefits received or other equitable relationship. Subject to the foregoing, a cost is allocable to a research agreement if it is incurred solely to advance the work under the research agreement; or it benefits both the research agreement and other work of the hospital in proportions that can be approximated through use of reasonable methods; or it is necessary to the overall operation of the hospital and, in light of the standards provided in this chapter, is deemed to be assignable in part to organized research. Where the purchase of equipment or other capital items are specifically authorized under a research agreement, the amounts thus authorized for such purchases are allocable to the research agreement regardless of the use that may subsequently be made of the equipment or other capital items involved.

2. Any costs allocable to a particular research agreement under the standards provided in these principles may not be shifted to other research agreements in order to meet deficiencies caused by overruns or other fund considerations, to avoid restrictions imposed by law or by terms of the research agreement, or for other reasons of convenience.

E. *Applicable credits.* 1. The term applicable credits refers to those receipts or negative expenditure types of transactions which operate to offset or reduce expense items that are allocable to research agreements as direct or indirect costs as outlined in para. V-A. Typical examples of such transactions are: purchase discounts, rebates, or allowances; recoveries or indemnities on losses; sales of scrap or incidental services; tuition; adjustments of overpayments or erroneous charges; and services rendered to patients admitted to federally funded clinical research centers, primarily for care though also participating in research protocols.

2. In some instances, the amounts received from the Federal Government to finance hospital activities or service operations should be treated as applicable credits. Specifically, the concept of netting such credit items against related expenditures should be applied by the hospital in determining the rates or amounts to be charged to government research for services rendered whenever the facilities or other resources used in providing such services have been financed directly, in whole or in part, by federal funds. Thus, where such items are provided for or benefit a particular hospital activity, i.e., patient care, research, instruction and training, or other, they should be treated as an offset to the indirect costs apportioned to that activity. Where the benefits are common to all hospital activities they should be treated as a credit to the total indirect cost pool before allocation to the various cost objectives.

IV. Direct costs

A. *General.* Direct costs are those that can be identified specifically with a particular cost center. For this purpose, the term cost center refers not only to the ultimate centers against which costs are finally lodged such as research agreements, but also to other established cost centers such as the individual accounts for recording particular objects or items of expense, and the separate account groupings designed to record the expenses incurred by individual organizational units, functions, projects and the like. In general, the administrative functions and service activities described in para. VI are identifiable as separate cost centers, and the expenses associated with such centers become eligible in due course for distribution as indirect costs of research agreements and other ultimate cost centers.

B. *Application to research agreements.* Identifiable benefit to the research work rather than the nature of the goods and services involved is the determining factor in distinguishing direct from indirect costs of research agreements. Typical of transactions chargeable to a research agreement as direct costs are the compensation of employees for the time or effort devoted to the performance of work under the research agreement, including related staff benefit and pension plan costs to the extent that such items are consistently accorded to all employees and treated by the hospital as direct rather than indirect costs (see para. V. B4b); the costs of materials consumed or expended in the performance of such work; and other items of expense incurred for the research agreement, such as extraordinary utility consumption. The cost of materials supplied from stock or services rendered by specialized facilities or other institutional service operations may be included as direct costs of research agreements provided such items are consistently treated by the institution as direct rather than indirect costs and are charged under a recognized method of costing or pricing designed to recover only the actual direct and indirect costs of such material or service and conforming to generally accepted cost accounting practices consistently followed by the institution.

V. Indirect costs

A. *General.* Indirect costs are those that have been incurred for common or joint objectives, and thus are not readily subject to treatment as direct costs of research agreements or other ultimate or revenue producing cost centers. In hospitals such costs normally are classified but not necessarily restricted to the following functional categories: Depreciation; Administrative

and General (including fringe benefits if not charged directly); Operation of Plant; Maintenance of Plant; Laundry and Linen Service; Housekeeping; Dietary; Maintenance of Personnel; and Medical Records and Library.

B. *Criteria for distribution.*—1. *Base period.* A base period for distribution of indirect costs is the period during which such costs are incurred and accumulated for distribution to work performed within that period. The base period normally should coincide with the fiscal year established by the hospital, but in any event the base period should be so selected as to avoid inequities in the distribution of costs.

2. *Need for cost groupings.* The overall objective of the allocation process is to distribute the indirect costs described in para. VI to organized research, patient care, instruction and training, and other hospital activities in reasonable proportions consistent with the nature and extent of the use of the hospital's resources by research personnel, medical staff, patients, students, and other personnel or organizations. In order to achieve this objective with reasonable precision, it may be necessary to provide for selective distribution by establishing separate groupings of cost within one or more of the functional categories of indirect costs referred to in para. V-A. In general, the cost groupings established within a functional category should constitute, in each case, a pool of those items of expense that are considered to be of like character in terms of their relative contribution to (or degree of remoteness from) the particular cost centers to which distribution is appropriate. Each such pool or cost grouping should then be distributed individually to the related cost centers, using the distribution base or method most appropriate in the light of the guides set out in B3 below. While this paragraph places primary emphasis on a step-down method of indirect cost computation, para. VIII provides an alternate method which may be used under certain conditions.

3. *Selection of distribution method.* Actual conditions must be taken into account in selecting the method or base to be used in distributing to related cost centers the expenses assembled under each of the individual cost groups established as indicated under B2 above. Where a distribution can be made by assignment of a cost grouping directly to the area benefited, the distribution should be made in that manner. Care should be given, however, to eliminate similar or duplicative costs from any other distribution made to this area. Where the expenses under a cost grouping are more general in nature, the distribution to related cost centers should be made through use of a selected base which will produce results which are equitable to both the Government and the hospital. In general, any cost element or cost-related factor associated with the hospital's work is potentially adaptable for use as a distribution base provided:

a. It can readily be expressed in terms of dollars or other quantitative measure (total direct expenditures, direct salaries, man-hours applied, square feet utilized, hours of usage, number of documents processed, population served, and the like); and

b. It is common to the related cost centers during the base period. The essential consideration in selection of the distribution base in each instance is that it is the one best suited for assigning the pool of costs to related cost centers in accord with the relative benefits derived; the traceable cause and effect relationship; or logic and reason, where neither benefit nor cause and effect relationship is determinable.

4. *General consideration on cost groupings.* The extent to which separate cost groupings and selective distribution would be appropriate at a hospital is a matter of judgment to be determined on a case-by-case basis. Typical situations which may warrant the establishment of two or more separate cost groups (based on account classification or analysis) within a functional category include but are not limited to the following:

a. Where certain items or categories of expense relate solely to one of the major divisions of the hospital (patient care, sponsored research, instruction and training, or other hospital activities) or to any two but not all, such expenses should be set aside as a separate cost grouping for direct assignment or selective distribution in accordance with the guides provided in B2 and B3 above.

b. Where any types of expense ordinary treated as indirect cost as outlined in para. V-A are charged to research agreements as direct costs, the similar type expenses applicable to other activities of the institution must through separate cost grouping be excluded from the indirect costs allocable to research agreements.

c. Where it is determined that certain expenses are for the support of a service unit or facility whose output is susceptible of measurement on a workload or other quantitative basis, such expenses should be set aside as a separate cost grouping for distribution on such basis to organized research and other hospital activities.

d. Where organized activities (including identifiable segments of organized research as well as the activities cited in para. II-E) provide their own purchasing, personnel administration, building maintenance, or housekeeping or similar service, the distribution of such elements of indirect cost to such activities should be accomplished through cost grouping which includes only that portion of central indirect costs (such as for overall management) which are properly allocable to such activities.

e. Where the hospital elects to treat as indirect

charges the costs of pension plans and other staff benefits, such costs should be set aside as a separate cost grouping for selective distribution to related cost centers, including organized research.

f. Where the hospital is affiliated with a medical school or some other institution which performs organized research on the hospital's premises, every effort should be made to establish separate cost groupings in the Administrative and General or other applicable category which will reasonably reflect the use of services and facilities by such research. (See also para. VII-A.3)

5. *Materiality.* Where it is determined that the use of separate cost groupings and selective distribution are necessary to produce equitable results, the number of such separate cost groupings within a functional category should be held within practical limits, after taking into consideration the materiality of the amounts involved and the degree of precision attainable through less selective methods of distribution.

C. *Administration of limitations on allowances for indirect costs.* 1. Research grants may be subject to laws and/or administrative regulations that limit the allowance for indirect costs under each such grant to a stated percentage of the direct costs allowed. Agencies that sponsor such grants will establish procedures which will assure that:

a. the terms and amount authorized in each case conform with the provisions of paragraphs III, V and IX of these principles as they apply to matters involving the consistent treatment and allowability of individual items of cost; and

b. the amount actually allowed for indirect costs under each such research grant does not exceed the maximum allowable under the limitation or the amount otherwise allowable under these principles, whichever is the smaller.

2. Where the actual allowance for indirect costs on any research grant must be restricted to the smaller of the two alternative amounts referred to in C1 above, such alternative amounts should be determined in accordance with the following guides:

a. The maximum allowable under the limitation should be established by applying the stated percentage to a direct cost base which shall include all items of expenditure authorized by the sponsoring agency for inclusion as part of the total cost for the direct benefit of the work under the grant; and

b. The amount otherwise allowable under these principles should be established by applying the current institutional indirect cost rate to those elements of direct cost which were included in the base on which the rate was computed.

3. When the maximum amount allowable under a statutory limitation or the terms of a research agreement is less than the amount otherwise allocable as indirect costs under these principles, the amount not recoverable as indirect costs under the research agreement involved may not be shifted to other research agreements.

VI. Identification and assignment of indirect costs

A. *Depreciation or use charge.* 1. The expenses under this heading should include depreciation (as defined in para. IX-B.9a) on buildings, fixed equipment, and movable equipment, except to the extent purchased through federal funds. Where adequate records for the recording of depreciation are not available, a use charge may be substituted for depreciation (See para. IX-B.)

2. The expenses included in this category should be allocated to applicable cost centers in a manner consistent with the guides set forth in para. V-B. on a basis that gives primary emphasis to (a) space utilization with respect to depreciation on buildings and fixed equipment; and (b) specific identification of assets and their use with respect to movable equipment as it relates to patient care, organized research, instruction and training, and other hospital activities. Where such records are not sufficient for the purpose of the foregoing, reasonable estimates will suffice as a means for effecting distribution of the amounts involved.

B. *Administration and general expenses.* 1. The expenses under this heading are those that have been incurred for the administrative offices of the hospital including accounting, personnel, purchasing, information centers, telephone expense, and the like which do not relate solely to any major division of the institution, i.e., solely to patient care, organized research, instruction and training, or other hospital activities.

2. The expenses included in this category may be allocated on the basis of total expenditures exclusive of capital expenditures, or salaries and wages in situations where the results of the distribution made on this basis are deemed to be equitable both to the Government and the hospital; otherwise the distribution of Administration and General expenses should be made through use of selected bases, applied to separate cost groupings established within this category of expenses in accordance with the guides set out in para. V-B.

C. *Operation of plant.* 1. The expenses under this heading are those that have been incurred by a central service organization or at the departmental level for the administration, supervision, and provision of utilities (exclusive of telephone expense) and protective services to the physical plant. They include expenses incurred for such items as power plant operations, general utility costs, elevator operations, protection services, and general parking lots.

2. The expenses included in this category should be allocated to applicable cost centers in a manner consistent with the guides provided in para. V-B. on a

basis that gives primary emphasis to space utilization. The allocations should be developed as follows:

a. Where actual space and related cost records are available or can readily be developed and maintained without significant change in the accounting practices, the amount distributed should be based on such records;

b. Where the space and related cost records maintained are not sufficient for purposes of the foregoing, a reasonable estimate of the proportion of total space assigned to the various costs centers normally will suffice as a means for effecting distribution of the amounts involved; or

c. Where it can be demonstrated that an area or volume or space basis of allocation is impractical or inequitable, other bases may be used provided consideration is given to the use of facilities by research personnel and others, including patients.

D. *Maintenance of plant.* 1. The expenses under this heading should include:

a. All salaries and wages pertaining to ordinary repair and maintenance work performed by employees on the payroll of the hospital;

b. All supplies and parts used in the ordinary repairing and maintaining of buildings and general equipment; and

c. Amounts paid to outside concerns for the ordinary repairing and maintaining of buildings and general equipment.

2. The expenses included in this category should be allocated to applicable cost centers in a manner consistent with the guides provided in para. V-B. on a basis that gives primary emphasis to space utilization. The allocations and apportionments should be developed as follows:

a. Where actual space and related cost records are available and can readily be developed and maintained without significant change in the accounting practices, the amount distributed should be based on such records;

b. Where the space and related cost records maintained are not sufficient for purposes of the foregoing, a reasonable estimate of the proportion of total space assigned to the various cost centers normally will suffice as a means for effecting distribution of the amounts involved; or

c. Where it can be demonstrated that an area or volume of space basis of allocation is impractical or inequitable, other basis may be used provided consideration is given to the use of facilities by research personnel and others, including patients.

E. *Laundry and linen.* 1. The expenses under this heading should include:

a. Salaries and wages of laundry department employees, seamstresses, clean linen handlers, linen delivery men, etc.;

b. Supplies used in connection with the laundry operation and all linens purchased; and

c. Amounts paid to outside concerns for purchased laundry and/or linen service.

2. The expense included in this category should be allocated to related cost centers in a manner consistent with the guides provided in para. V-B. on a basis that gives primary emphasis to actual pounds of linen used. The allocations should be developed as follows:

a. Where actual poundage and related cost records are available or can readily be developed and maintained without significant change in the accounting practices, the amount distributed should be based on such records;

b. Where it can be demonstrated that a poundage basis of allocation is impractical or inequitable other bases may be used provided consideration is given to the use of linen by research personnel and others, including patients.

F. *Housekeeping.* 1. The expenses under this heading should include:

a. All salaries and wages of the department head, foreman, maids, porters, janitors, wall washers, and other housekeeping employees;

b. All supplies used in carrying out the housekeeping functions; and

c. Amounts paid to outside concerns for purchased services such as window washing, insect extermination, etc.

2. The expenses included in this category should be allocated to related cost centers in a manner consistent with the guides provided in para. V-B. on a basis that gives primary emphasis to space actually serviced by the housekeeping department. The allocations and apportionments should be developed as follows:

a. Where actual space serviced and related cost records are available or can readily be developed and maintained without significant change in the accounting practices, the amount distributed should be based on such records;

b. Where the space serviced and related cost records maintained are not sufficient for purposes of the foregoing, a reasonable estimate of the proportion of total space assigned to the various cost centers normally will suffice as a means for effecting distribution of the amounts of housekeeping expenses involved; or

c. Where it can be demonstrated that the space serviced basis of allocation is impractical or inequitable, other bases may be used provided consideration is given to the use of housekeeping services by research personnel and others, including patients.

G. *Dietary.* 1. These expenses, as used herein, shall mean only the subsidy provided by the hospital to its employees including research personnel through its cafeteria operation. The hospital must be able to demonstrate through the use of proper cost accounting techniques that the cafeteria operates at a loss to the

benefit of employees.

2. The reasonable operating loss of a subsidized cafeteria operation should be allocated to related cost centers in a manner consistent with the guides provided in para. V-B. on a basis that gives primary emphasis to number of employees.

H. *Maintenance (housing) of personnel.* 1. The expenses under this heading should include:

a. The salaries and wages of matrons, clerks, and other employees engaged in work in nurses' residences and other employees' quarters;

b. All supplies used in connection with the operation of such dormitories; and

c. Payments to outside agencies for the rental of houses, apartments, or rooms used by hospital personnel.

2. The expenses included in this category should be allocated to related cost centers in a manner consistent with the guides provided in para. V-B. on a basis that gives primary emphasis to employee utilization of housing facilities. The allocation should be developed as follows:

a. Appropriate credit should be given for all payments received from employees or otherwise to reduce the expense to be allocated;

b. A net cost per housed employee may then be computed; and

c. Allocation should be made on a departmental basis based on the number of housed employees in each respective department.

I. *Medical records and library.* 1. The expenses under this heading should include:

a. The salaries and wages of the records librarian, medical librarian, clerks, stenographers, etc.; and

b. All supplies such as medical record forms, chart covers, filing supplies, stationery, medical library books, periodicals, etc.

2. The expenses included in this category should be allocated to related cost centers in a manner consistent with the guides provided in para. V-B. on a basis that gives primary emphasis to a special time survey of medical records personnel. If this appears to be impractical or inequitable, other bases may be used provided consideration is given to the use of these facilities by research personnel and others, including patients.

VII. Determination and application of indirect cost rate or rates

A. *Indirect cost pools.* 1. Subject to (2) below, indirect costs allocated to organized research should be treated as a common pool, and the costs in such common pool should be distributed to individual research agreements benefiting therefrom on a single rate basis.

2. In some instances a single rate basis for use on all government research at a hospital may not be appropriate since it would not take into account those different environmental factors which may affect substantially the indirect costs applicable to a particular segment of government research at the institution. For this purpose, a particular segment of government research may be that performed under a single research agreement or it may consist of research under a group of research agreements performed in a common environment. The environmental factors are not limited to the physical location of the work. Other important factors are the level of the administrative support required, the nature of the facilities or other resources employed, the scientific disciplines or technical skills involved, the organizational arrangements used, or any combination thereof. Where a particular segment of government research is performed within an environment which appears to generate a significantly different level of indirect costs, provision should be made for a separate indirect cost pool applicable to such work. An example of this differential may be in the development of a separate indirect cost pool for a clinical research center grant. The separate indirect cost pool should be developed during the course of the regular distribution process, and the separate indirect cost rate resulting therefrom should be utilized provided it is determined that:

a. Such indirect cost rate differs significantly from that which would have obtained under (1) above; and

b. The volume of research work to which such rate would apply is material in relation to other government research at the institution.

3. It is a common practice for grants or contracts awarded to other institutions, typically University Schools of Medicine, to be performed on hospital premises. In these cases the hospital should develop a separate indirect cost pool applicable to the work under such grants or contracts. This pool should be developed by a selective distribution of only those indirect cost categories which benefit the work performed by the other institution, within the practical limits dictated by available data and the materiality of the amounts involved. Hospital costs determined to be allocable to grants or contracts awarded to another institution may not be recovered as a cost of grants or contracts awarded directly to the hospital.

B. *The distribution base.* Preferably, indirect costs allocated to organized research should be distributed to applicable research agreements on the basis of direct salaries and wages. However, where the use of salaries and wages results in an inequitable allocation of costs to the research agreements, total direct costs or a variation thereof, may be used in lieu of salaries and wages. Regardless of the base used, an indirect cost rate should be determined for each of the separate indirect cost pools developed pursuant to para. VII-A. The rate in each case should be stated as the percentage

which the amount of the particular indirect cost pool is of the total direct salaries and wages (or other base selected) for all research agreements identified with such a pool.

C. *Negotiated lump sum for overhead.* A negotiated fixed amount in lieu of indirect costs may be appropriate for self-contained or off-campus research activities where the benefits derived from a hospital's indirect services cannot be readily determined. Such amount negotiated in lieu of indirect costs will be treated as an offset to the appropriate indirect cost pool after allocation to patient care, organized research, instruction and training, and other hospital activities. The base on which such remaining expenses are allocated should be appropriately adjusted.

D. *Predetermined overhead rates.* The utilization of predetermined fixed overhead rates may offer potential advantages in the administration of research agreements by facilitating the preparation of research budgets and permitting more expeditious close out of the agreements when the work is completed. Therefore, to the extent allowed by law, consideration may be given to the negotiation of predetermined fixed rates in those situations where the cost experience and other pertinent factors available are deemed sufficient to enable the Government and the hospital to reach a reasonable conclusion as to the probable level of the indirect cost rate for the ensuing accounting period.

VIII. Simplified method for small institutions

A. *General* 1. Where the total direct cost of all government-sponsored research and development work at a hospital in a year is minimal, the use of the abbreviated procedure described in para. VIII-B below may be acceptable in the determination of allowable indirect costs. This method may also be used to initially determine a provisional indirect cost rate for hospitals that have not previously established a rate. Under this abbreviated procedure, data taken directly from the institution's most recent annual financial report and immediately available supporting information will be utilized as a basis for determining the indirect cost rate applicable to research agreements at the institution.

2. The rigid formula approach provided under the abbreviated procedure has limitations which may preminimum data required for this purpose are not readily clude its use at some hospitals either because the available or because the application of the abbreviated procedure to the available data produces results which appear inequitable to the Government or the hospital. In any such case, indirect costs should be determined through use of the regular procedure rather than the abbreviated procedure.

3. In certain instances where the total direct cost of all government-sponsored research and development work at the hospital is more than minimal, the abbreviated procedure may be used if prior permission is obtained. This alternative will be granted only in those cases where it can be demonstrated that the step-down technique cannot be followed.

B. *Abbreviated procedure.* 1. Total expenditures as taken from the most recent annual financial report will be adjusted by eliminating from further consideration expenditures for capital items as defined in para. IX-B.4 and unallowable costs as defined under various headings in para. IX and para. III-E.

2. Total expenditures as adjusted under the foregoing will then be distributed among (a) expenditures applicable to administrative and general overhead functions, (b) expenditures applicable to all other overhead functions, and (c) expenditures for all other purposes. The first group shall include amounts associated with the functional categories, Administration and General, and Dietary, as defined in para. VI. The second group shall include Depreciation, Operation of Plant, Maintenance of Plant, and Housekeeping. The third group—expenditures for all other purposes—shall include the amounts applicable to all other activities, namely, patient care, organized research, instruction and training, and other hospital activities as defined under para. II-E. For the purposes of this section, the functional categories of Laundry and Linen, Maintenance of Personnel, and Medical Records and Library as defined in para. VI shall be considered as expenditures for all other purposes.

3. The expenditures distributed to the first two groups in para. VIII-B.2 should then be adjusted by those receipts or negative expenditure types of transactions which tend to reduce expense items allocable to research agreements as indirect costs. Examples of such receipts or negative expenditures are itemized in para. III-E.1.

4. In applying the procedures in para. VIII-B.1 and B.2., the cost of unallowable activities such as Gift Shop, Investment Property Management, Fund Raising, and Public Relations, when they benefit from the hospital's indirect cost services, should be treated as expenditures for all other purposes. Such activities are presumed to benefit from the hospital's indirect cost services when they include salaries of personnel working in the hospital. When they do not include such salaries, they should be eliminated from the indirect cost rate computation.

5. The indirect cost rate will then be computed in two stages. The first stage requires the computation of an Administrative and General rate component. This is done by applying a ratio of research direct costs over total direct costs to the Administrative and General pool developed under para. VIII-B.2 and B.3. above. The resultant amount—that which is allocable to research—is divided by the direct research cost base.

The second stage requires the computation of an All other Indirect Cost rate component. This is done by applying a ratio of research direct space over total direct space to All Other Indirect Cost pool developed under para. VIII B.2. and B.3 above. The resultant amount—that which is allocable to research—is divided by the direct research cost base.

The total of the two rate components will be the institution's indirect cost rate. For the purposes of this section, the research direct cost or space and total direct cost or space will be that cost or space identified with the functional categories classified under Expenditures for all other purposes under para. VIII-B.2.

IX. General standard for selected items of cost

A. *General.* This section provides standards to be applied in establishing the allowability of certain items involved in determining cost. These standards should apply irrespective of whether a particular item of cost is properly treated as direct cost or indirect cost. Failure to mention a particular item of cost in the standards is not intended to imply that it is either allowable or unallowable; rather, determination as to allowability in each case should be based on the treatment or standards provided for similar or related items of cost. In case of discrepancy between the provisions of a specific research agreement and the applicable standards provided, the provisions of the research agreement should govern. However, in some cases advance understandings should be reach on particular cost items in order that the full costs of research be supported. The extent of allowability of the selected items of cost covered in this section has been stated to apply broadly to many accounting system in varying environmental situations. Thus, as to any given research agreement, the reasonableness and allocability of certain items of costs may be difficult to determine, particularly in connection with hospitals which have medical school or other affiliations. In order to avoid possible subsequent disallowance or dispute based on unreasonableness or nonallocability, it is important that prospective recipients of federal funds particularly those whose work is predominantly or substantially with the Government, seek agreement with the Government in advance of the incurrence of special or unusual costs in categories where reasonableness or allocability are difficult to determine. Such agreement may also be initiated by the Government. Any such agreement should be incorporated in the research agreement itself. However, the absence of such an advance agreement on any element of cost will not in itself serve to make that element either allowable or unallowable. Examples of costs on which advance agreements may be particularly important are:

1. Facilities costs, such as;

a. Depreciation

b. Rental

c. Use charges for fully depreciated assets

d. Idle facilities and idle capacity

e. Plant reconversion

f. Extraordinary or deferred maintenance and repair

g. Acquisition of automatic data processing equipment

2. Preaward costs

3. Non-hospital professional activities

4. Self-insurance

5. Support services charged directly (computer services, printing and duplicating services, etc.)

6. Employee compensation, travel, and other personnel costs, including;

a. Compensation for personal service, including wages and salaries, bonuses and incentives, premium payments, pay for time not worked, and supplementary compensation and benefits, such as pension and retirement, group insurance, severance pay plans, and other forms of compensation

b. Morale, health, welfare, and food service and dormitory costs

c. Training and education costs

d. Relocation costs, including special or mass personnel movement

B. *Selected items.—1. Advertising costs.* The term advertising costs means the costs of advertising media and corollary administrative costs. Advertising media include magazines, newspapers, radio and television programs, direct mail, exhibits, and the like. The only advertising costs allowable are those which are solely for;

a. The recruitment of persons required for the performance by the institution of obligations arising under the research agreement, when considered in conjunction with all other recruitment costs as set forth in para IX-B.34

b. The procurement of scarce items for the performance of the research agreement; or

c. The disposal of scrap or surplus materials acquired in the performance of the research agreement.

Costs of this nature, if incurred for more than one research agreement, or for both research agreement work and other work of the institution, are allowable to the extent that the principles in paragraph IV and V are observed.

2. *Bad debts.* Losses arising from uncollectible accounts and other claims and related collection and legal costs are unallowable except that a bad debt may be included as a direct cost of the research agreement to the extent that it is caused by a research patient and approved by the awarding agency. This inclusion is only intended to cover the situation of the patient admitted for research purposes who subsequently or in conjunction with the research receives clinical care

for which a charge is made to the patient. If, after exhausting all means of collecting these charges, a bad debt results, it may be considered an appropriate charge to the research agreement.

3. *Bonding costs.* a. Bonding costs arise when the Government requires assurance against financial loss to itself or others by reason of the act or default of the hospital. They arise also in instances where the hospital requires similar assurance.

Included are such types as bid, performance, payment, advance payment, infringement, and fidelity bonds.

b. Costs of bonding required pursuant to the terms of the research agreement are allowable.

c. Costs of bonding required by the hospital in the general conduct of its business are allowable to the extent that such bonding is in accordance with sound business practice and the rates and premiums are reasonable under the circumstances.

4. *Capital expenditures.* The costs of equipment, buildings, and repairs which materially increase the value or useful life of buildings or equipment should be capitalized and are unallowable except as provided for in the research agreement.

5. *Civil defense costs.* Civil defense costs are those incurred in planning for, and the protection of life and property against the possible effects of enemy attack. Reasonable costs of civil defense measures (including costs in excess of normal plant protection costs, first-aid training and supplies, fire-fighting training, posting of additional exit notices and directions, and other approved civil defense measures) undertaken on the institution's premises pursuant to suggestions or requirements of civil defense authorities are allowable when distributed to all activities of the institution. Capital expenditures for civil defense purposes will not be allowed, but a use allowance or depreciation may be permitted in accordance with provisions set forth elsewhere. Costs of local civil defense projects not on the institution's premises are unallowable.

6. *Communication costs.* Costs incurred for telephone services, local and long distance telephone calls, telegrams, radiograms, postage, and the like are allowable.

7. *Compensation for personal services.*— a. *General.* Compensation for personal services covers all remuneration paid currently or accrued to employees of the hospital for services rendered during the period of performance under government research agreements. Such remuneration includes salaries, wages, staff benefits (see para. IX-B.10), and pension plan costs (see para. IX-B.25). The costs of such remuneration are allowable to the extent that the total compensation to individual employees is reasonable for the services rendered and conforms to the established policy of the institution consistently applied, and provided that the charges for work performed directly on government research agreements and for other work allocable as indirect costs to sponsored research are determined and supported as hereinafter provided. For non-profit, non-proprietary institutions, where federally supported programs constitute less than a preponderance of the activity at the institution the primary test of reasonableness will be to require that the institution's compensation policies be applied consistently both to federally-sponsored and non-sponsored activities alike. However, where special circumstances so dictate a contractual clause may be utilized which calls for application of the test of comparability in determining the reasonableness of compensation.

b. *Payroll distribution.* Amounts charged to organized research for personal services, regardless of whether treated as direct costs or allocated as indirect costs, will be based on hospital payrolls which have been approved and documented in accordance with generally accepted hospital practices. In order to develop necessary direct and indirect allocations of cost, supplementary data on time or effort as provided in (c) below, normally need be required only for individuals whose compensation is properly chargeable to two or more research agreements or to two or more of the following broad functional categories: (1) patient care; (2) organized research; (3) instruction and training; (4) indirect activities as defined in para. V-A; or (5) other hospital activities as defined in para. II-E.

c. *Reporting time or effort.* Charges for salaries and wages of individuals other than members of the professional staff will be supported by daily time and attendance and payroll distribution records. For members of the professional staff, current and reasonable estimates of the percentage distribution of their total effort may be used as support in the absence of actual time records. The term professional staff for purposes of this section includes physicians, research associates, and other personnel performing work at responsible levels of activities. These personnel normally fulfill duties, the competent performance of which usually requires persons possessing degrees from accredited institutions of higher learning and or state licensure. In order to qualify as current and reasonable, estimates must be made no later than one month (though not necessarily a calendar month) after the month in which the services were performed.

d. *Preparation of estimates of effort.* Where required under (c) above, estimates of effort spent by a member of the professional staff on each research agreement should be prepared by the individual who performed the services or by a responsible individual such as a department head or supervisor having first-hand knowledge of the services performed on each research agreement. Estimates must show the allocation of effort

between organized research and all other hospital activities in terms of the percentage of total effort devoted to each of the broad functional categories referred to in (b) above. The estimate of effort spent on a research agreement may include a reasonable amount of time spent in activities contributing and intimately related to work under the agreement, such as preparing and delivering special lectures about specific aspects of the ongoing research, writing research reports and articles, participating in appropriate research seminars, consulting with colleagues with respect to related research, and attending appropriate scientific meetings and conferences. The term "all other hospital activities" would include departmental research, administration, committee work, and public services undertaken on behalf of the hospital.

e. *Application of budget estimates.* Estimates determined before the performance of services, such as budget estimates on a monthly, quarterly, or yearly basis do not qualify as estimates of effort spent.

f. *Non-hospital professional activities.* A hospital must not alter or waive hospital-wide policies and practices dealing with the permissible extent of professional services over and above those traditionally performed without extra hospital compensation, unless such arrangements are specifically authorized by the sponsoring agency. Where hospital-wide policies do not adequately define the permissible extent of consultantships or other non-hospital activities undertaken for extra pay, the Government may require that the effort of professional staff working under research agreements be allocated as between (1) hospital activities, and (2) non-hospital professional activities. If the sponsoring agency should consider the extent of non-hospital professional effort excessive, appropriate arrangements governing compensation will be negotiated on a case by case basis.

g. *Salary rates for part-time appointments.* Charges for work performed on government research by staff members having only part-time appointments will be determined at a rate not in excess of that for which he is regularly paid for his part-time staff assignment.

8. *Contingency provisions.* Contributions to a contingency reserve or any similar provisions made for events the occurrence of which cannot be foretold with certainty as to time, intensity, or with an assurance of their happening, are unallowable.

9. *Depreciation and use allowances.* a. Hospitals may be compensated for the use of buildings, capital improvements and usable equipment on hand through depreciation or use allowances. Depreciation is a charge to current operations which distributes the cost of a tangible capital asset, less estimated residual value, over the estimated useful life of the asset in a systematic and logical manner. It does not involve a process of valuation. Useful life has reference to the prospective period of economic usefulness in the particular hospital's operations as distinguished from physical life. Use allowances are the means of allowing compensation when depreciation or other equivalent costs are not considered.

b. Due consideration will be given to government-furnished research facilities utilized by the institution when computing use allowances and/or depreciation if the government-furnished research facilities are material in amount. Computation of the use allowance and/or depreciation will exclude both the cost or any portion of the cost of grounds, buildings and equipment borne by or donated by the Federal Government, irrespective of where title was originally vested or where it presently resides, and secondly, the cost of grounds. Capital expenditures for land improvements (paved areas, fences, streets, sidewalks, utility conduits, and similar improvements not already included in the cost of buildings) are allowable provided the systematic amortization of such capital expenditures has been provided in the institution's books of accounts, based on reasonable determinations of the probable useful lives of the individual items involved, and the share allocated to organized research is developed from the amount thus amortized for the base period involved.

c. Normal depreciation on a hospital's plant, equipment, and other capital facilities, except as excluded by (d) below, is an allowable element of research cost provided that the amount thereof is computed:

1. Upon the property cost basis used by the hospital for Federal Income Tax purposes (See section 167 of the Internal Revenue Code of 1954); or

2. In the case of non-profit or tax exempt organizations, upon a property cost basis which could have been used by the hospital for Federal Income Tax purposes, had such hospital been subject to the payment of income tax; and in either case

3. By the consistent application to the assets concerned of any generally accepted accounting method, and subject to the limitations of the Internal Revenue Code of 1954 as amended, including—

i. The straight line method;

ii. The declining balance method, using a rate not exceeding twice the rate which would have been used had the annual allowance been computed under the method described in (i) above;

iii. The sum of the years-digits method; and

iv. Any other consistent method productive of an annual allowance which, when added to all allowances for the period commencing with the use of the property and including the current year, does not during the first two-thirds of the useful life of the property exceed the total of such allowances which would have been used had such allowances been computed under the method described in (ii) above.

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d. Where the depreciation method is followed, adequate property records must be maintained. The period of useful service (service life) established in each case for usable capital assets must be determined on a realistic basis which takes into consideration such factors as type of construction, nature of the equipment used, technological developments in the particular research area, and the renewal and replacement policies followed for the individual items or classes of assets involved. Where the depreciation method is introduced for application to assets acquired in prior years, the annual charges therefrom must not exceed the amounts that would have resulted had the depreciation method been in effect from the date of acquisition of such assets.

e. Depreciation on idle or excess facilities shall not be allowed except on such facilities as are reasonably necessary for standby purposes.

f. Where an institution elects to go on a depreciation basis for a particular class of assets, no depreciation, rental or use charge may be allowed on any such assets that would be viewed as fully depreciated; provided, however, that reasonable use charges may be negotiated for any such assets if warranted after taking into consideration the cost of the facility or item involved, the estimated useful life remaining at time of negotiation, the actual replacement policy followed in the light of service lives used for calculating depreciation, the effect of any increased maintenance charges or decreased efficiency due to age, and any other factors pertinent to the utilization of the facility or item for the purpose contemplated.

g. Hospitals which choose a depreciation allowance for assets purchased prior to 1966 based on a percentage of operating costs in lieu of normal depreciation for purposes of reimbursement under Public Law 89-97 (Medicare) shall utilize that method for determining depreciation applicable to organized research.

The operating costs to be used are the lower of the hospital's 1965 operating costs or the hospital's current year's allowable costs. The percent to be applied is 5 percent starting with the year 1966-67, with such percentage being uniformity reduced by one-half percent each succeeding year. The allowance based on operating costs is in addition to regular depreciation on assets acquired after 1965. However, the combined amount of such allowance on pre-1966 assets and the allowance for actual depreciation on assets acquired after 1965 may not exceed 6 percent of the hospital's allowable cost for the current year. After total depreciation has been computed, allocation methods are used to determine the share attributable to organized research.

For purposes of this section, "Operating Costs" means the total costs incurred by the hospital in operating the institution, and includes patient care, research, and other activities. "Allowable Costs" means operating costs less unallowable costs as defined in these principles; by the application of allocation methods to the total amount of such allowable costs, the share attributable to Federally-sponsored research is determined.

A hospital which elects to use this procedure under Public Law 89-97 and subsequently changes to an actual depreciation basis on pre-1966 assets in accordance with the option afforded under the Medicare program shall simultaneously change to an actual depreciation basis for organized research.

Where the hospital desires to change to actual depreciation but either has no historical cost records or has incomplete records, the determination of historical cost could be made through appropriate means involving expert consultation with the determination being subject to review and approval by the Department of Health and Human Services.

h. Where the use allowance method is followed, the use allowance for buildings and improvements will be computed at an annual rate not exceeding two percent of acquisition cost. The use allowance for equipment will be computed at an annual rate not exceeding six and two-thirds percent of acquisition cost of usable equipment in those cases where the institution maintains current records with respect to such equipment on hand. Where the institution's records reflect only the cost (actual or estimated) of the original complement of equipment, the use allowance will be computed at an annual rate not exceeding ten percent of such cost. Original complement for this purpose means the complement of equipment initially placed in buildings to perform the functions currently being performed in such buildings; however, where a permanent change in the function of a building takes place, a redetermination of the original complement of equipment may be made at that time to establish a new original complement. In those cases where no equipment records are maintained, the institution will justify a reasonable estimate of the acquisition cost of usable equipment which may be used to compute the use allowance at an annual rate not exceeding six and two-thirds percent of such estimate.

i. Depreciation and/or use charges should usually be allocated to research and other activities as an indirect cost.

10. *Employee morale, health, and welfare costs and credits.* The costs of house publications, health or first-aid benefits, recreational activities, employees' counseling services, and other expenses incurred in accordance with the hospital's established practice or custom for the improvement of working conditions, employer-employee relations, employee morale, and employee performance, are allowable. Such costs will be equitably

apportioned to all activities of the hospital. Income generated from any of these activities will be credited to the cost thereof unless such income has been irrevocably set over to employee welfare organizations.

11. *Entertainment costs.* Except as pertains to 10 above, costs incurred for amusement, social activities, entertainment, and any items relating thereto, such as meals, lodging, rentals, transportation, and gratuities are unallowable.

12. *Equipment and other facilities.* The cost of equipment or other facilities are allowable on a direct charge basis where such purchases are approved by the sponsoring agency concerned or provided for by the terms of the research agreement.

13. *Fines and penalties.* Costs resulting from violations of, or failure of the institution to comply with federal, state and local laws and regulations are unallowable except when incurred as a result of compliance with specific provisions of the research agreement, or instructions in writing from the awarding agency.

14. *Insurance and indemnification.* a. Costs of insurance required or approved and maintained pursuant to the research agreement are allowable.

b. Costs of other insurance maintained by the hospital in connection with the general conduct of its activities are allowable subject to the following limitations: (1) types and extent and cost of coverage must be in accordance with sound institutional practice; (2) costs of insurance or of any contributions to any reserve covering the risk of loss of or damage to government owned property are unallowable except to the extent that the Government has specifically required or approved such costs; and (3) costs of insurance on the lives of officers or trustees are unallowable except where such insurance is part of an employee plan which is not unduly restricted.

c. Contributions to a reserve for an approved self-insurance program are allowable to the extent that the types of coverage, extent of coverage, and the rates and premiums would have been allowed had insurance been purchased to cover the risks. Such contributions are subject to prior approval of the Government.

d. Actual losses which could have been covered by permissible insurance (through an approved self-insurance program or otherwise) are unallowable unless expressly provided for in the research agreement, except that costs incurred because of losses not covered under nominal deductible insurance coverage provided in keeping with sound management practice as well as minor losses not covered by insurance such as spoilage, breakage and disappearance of small hand tools which occur in the ordinary course of operations are allowable.

15. *Interest, fund raising and investment management costs.* a. Costs incurred for interest on borrowed capital or temporary use of endowment funds, however represented, are unallowable.

b. Costs of organized fund raising, including financial campaigns, endowment drives, solicitation of gifts and bequests, and similar expenses incurred solely to raise capital or obtain contributions are not allowable.

c. Costs of investment counsel and staff and similar expenses incurred solely to enhance income from investments are not allowable.

d. Costs related to the physical custody and control of monies and securities are allowable.

16. *Labor relations costs.* Costs incurred in maintaining satisfactory relations between the hospital and its employees, including costs of labor management committees, employees' publications, and other related activities are allowable.

17. *Losses on research agreements or contracts.* Any excess of costs over income under any agreement or contract of any nature is unallowable. This includes, but is not limited to, the hospital's contributed portion by reason of cost-sharing agreements, underrecoveries through negotiation of flat amounts for overhead, or legal or administrative limitations.

18. *Maintenance and repair costs.* a. Costs necessary for the upkeep of property (including government property unless otherwise provided for), which neither add to the permanent value of the property nor appreciably prolong its intended life, but keep it in an efficient operating condition, are to be treated as follows:

1. Normal maintenance and repair costs are allowable;

2. Extraordinary maintenance and repair costs are allowable, provided they are allocated to the periods to which applicable for purposes of determining research costs.

b. Expenditures for plant and equipment, including rehabilitation thereof, which according to generally accepted accounting principles as applied under the hospital's established policy, should be capitalized and subjected to depreciation, are allowable only on a depreciation basis.

19. *Material costs.* Costs incurred for purchased materials, supplies and fabricated parts directly or indirectly related to the research agreement, are allowable. Purchases made specifically for the research agreement should be charged thereto at their actual prices after deducting all cash discounts, trade discounts, rebates, and allowances received by the institution. Withdrawals from general stores or stockrooms should be charged at their cost under any recognized method of pricing stores withdrawals conforming to sound accounting practices consistently followed by the hospital. Incoming transportation charges are a proper part of material cost. Direct material cost should include only the materials and supplies actually used for the performance of the research agreement, and due credit should be given for any excess materials retained or returned to vendors. Due credit should be given for all proceeds

or value received for any scrap resulting from work under the research agreement. Where government donated or furnished material is used in performing the research agreement, such material will be used without charge.

20. *Memberships, subscriptions and professional activity costs.* a. Costs of the hospital's membership in civic, business, technical and professional organizations are allowable.

b. Costs of the hospital's subscriptions to civic, business, professional and technical periodicals are allowable.

c. Costs of meetings and conferences, when the primary purpose is the dissemination of technical information, are allowable. This includes costs of meals, transportation, rental of facilities, and other items incidental to such meetings or conferences.

21. *Organization costs.* Expenditures such as incorporation fees, attorneys' fees, accountants' fees, brokers' fees, fees to promoters and organizers in connection with (a) organization or reorganization of a hospital, or (b) raising capital, are unallowable.

22. *Other business expenses.* Included in this item are such recurring expenses as registry and transfer charges resulting from changes in ownership of securities issued by the hospital, cost of shareholders meetings preparation and publication of reports to shareholders, preparation and submission of required reports and forms to taxing and other regulatory bodies, and incidental costs of directors and committee meetings. The above and similar costs are allowable when allocated on an equitable basis.

23. *Patient care.* The cost of routine and ancillary or special services to research patients is an allowable direct cost of research agreements.

a. Routine services shall include the costs of the regular room, dietary and nursing services, minor medical and surgical supplies and the use of equipment and facilities for which a separate charge is not customarily made.

b. Ancillary or special services are the services for which charges are customarily made in addition to routine services, such as operating rooms, anesthesia, laboratory, BMR-EKG, etc.

c. Patient care, whether expressed as a rate or an amount, shall be computed in a manner consistent with the procedures used to determine reimbursable costs under Public Law 89–97 (Medicare Program) as defined under the "Principles Of Reimbursement For Provider Costs" published by the Social Security Administration of the Department of Health and Human Services. The allowability of specific categories of cost shall be in accordance with those principles rather than the principles for research contained herein. In the absence of participation in the Medicare program by a hospital, all references to the Medicare program in these principles shall be construed as meaning the Medicaid program.

i. Once costs have been recognized as allowable, the indirect costs or general service center's cost shall be allocated (stepped-down) to special service centers, and all patient and nonpatient costs centers based upon actual services received or benefiting these centers.

ii. After allocation, routine and ancillary costs shall be apportioned to scatter-bed research patients on the same basis as is used to apportion costs to Medicare patients, i.e. using either the departmental method or the combination method, as those methods are defined by the Social Security Administration; except that final settlement shall be on a grant-by-grant basis. However, to the extent that the Social Security Administration has recognized any other method of cost apportionment, that method generally shall also be recognized as applicable to the determination of research patient care costs.

iii. A cost center must be established on Medicare reimbursement forms for each discrete-bed unit grant award received by a hospital. Routine costs should be stepped-down to this line item(s) in the normal course of stepping-down costs under Medicare/Medicaid requirements. However, in stepping-down routine costs, consideration must be given to preventing a step-down of those costs to discrete-bed unit line items that have already been paid for directly by the grant, such as bedside nursing costs. Ancillary costs allocable to research discrete-bed units shall be determined and proposed in accordance with Section 23.c.ii.

d. Where federally sponsored research programs provide specifically for the direct reimbursement of nursing, dietary, and other services, appropriate adjustment must be made to patient care costs to preclude duplication and/or misallocation of costs.

24. *Patent costs.* Costs of preparing disclosures, reports and other documents required by the research agreement and of searching the art to the extent necessary to make such invention disclosures are allowable. In accordance with the clauses of the research agreement relating to patents, costs of preparing documents and any other patent costs, in connection with the filing of a patent application where title is conveyed to the Government, are allowable. (See also para. IX-B.36.)

25. *Pension plan costs.* Costs of the hospital's pension plan which are incurred in accordance with the established policies of the institution are allowable, provided such policies meet the test of reasonableness and the methods of cost allocation are not discriminatory, and provided appropriate adjustments are made for credits or gains arising out of normal and abnormal employee turnover or any other contingencies that can

result in forfeitures by employees which inure to the benefit of the hospital.

26. *Plan security costs.* Necessary expenses incurred to comply with government security requirements including wages, uniforms and equipment of personnel engaged in plant protection are allowable.

27. *Preresearch agreement costs.* Costs incurred prior to the effective date of the research agreement, whether or not they would have been allowable thereunder if incurred after such date, are unallowable unless specifically set forth and identified in the research agreement.

28. *Professional services costs.* a. Costs of professional services rendered by the members of a particular profession who are not employees of the hospital are allowable subject to (b) and (c) below when reasonable in relation to the services rendered and when not contingent upon recovery of the costs from the Government. Retainer fees to be allowable must be reasonably supported by evidence of services rendered.

b. Factors to be considered in determining the allowability of costs in a particular case include (1) the past pattern of such costs, particularly in the years prior to the award of government research agreements on the institution's total activity; (2) the nature and scope of managerial services expected of the institution's own organizations; and (3) whether the proportion of government work to the hospital's total activity is such as to influence the institution in favor of incurring the cost, particularly where the services rendered are not of a continuing nature and have little relationship to work under government research agreements.

c. Costs of legal, accounting and consulting services, and related costs incurred in connection with organization and reorganization or the prosecution of claims against the Government are unallowable. Costs of legal, accounting and consulting services, and related costs incurred in connection with patent infringement litigation are unallowable unless otherwise provided for in the research agreement.

29. *Profits and losses on disposition of plant equipment, or other assets.* Profits or losses of any nature arising from the sale or exchange of plant, equipment, or other capital assets, including sales or exchange of either short- or long-term investments, shall be excluded in computing research agreement costs.

30. *Proposal costs.* Proposal costs are the costs of preparing bids or proposals on potential government and non-government research agreements or projects, including the development of technical data and cost data necessary to support the institution's bids or proposals. Proposal costs of the current accounting period of both successful and unsuccessful bids and proposals normally should be treated as indirect costs and allocated currently to all activities of the institution, and no proposal costs of past accounting periods will be allocable in the current period to the government research agreement. However, the institution's established practices may be to treat proposal costs by some other recognized method. Regardless of the methods used, the results obtained may be accepted only if found to be reasonable and equitable.

31. *Public information service costs.* Costs of news releases pertaining to specific research or scientific accomplishment are unallowable unless specifically authorized by the sponsoring agency.

32. *Rearrangement and alteration costs.* Costs incurred for ordinary or normal rearrangement and alteration of facilities are allowable. Special rearrangement and alteration costs incurred specifically for a project are allowable only as a direct charge when such work has been approved in advance by the sponsoring agency concerned.

33. *Reconversion costs.* Costs incurred in the restoration or rehabilitation of the institution's facilities to approximately the same condition existing immediately prior to commencement of government research agreement work, fair wear and tear excepted, are allowable.

34. *Recruiting costs.* a. Subject to (b), (c), and (d) below, and provided that the size of the staff recruited and maintained is in keeping with workload requirements, costs of "help wanted" advertising, operating costs of an employment office necessary to secure and maintain an adequate staff, costs of operating an aptitude and educational testing program, travel costs of employees while engaged in recruiting personnel, travel costs of applicants for interviews for prospective employment, and relocation costs incurred incident to recruitment of new employees are allowable to the extent that such costs are incurred pursuant to a well managed recruitment program. Where an institution uses employment agencies, costs not in excess of standard commercial rates for such services are allowable.

b. In publication, costs of help wanted advertising that includes color, includes advertising material for other than recruitment purposes, or is excessive in size (taking into consideration recruitment purposes for which intended and normal institutional practices in this respect) are unallowable.

c. Costs of help wanted advertising, special emoluments; fringe benefits, and salary allowances incurred to attract professional personnel from other institutions that do not meet the test of reasonableness or do not conform with the established practices of the institution are unallowable.

d. Where relocation costs incurred incident to recruitment of a new employee have been allowed either as an allocable direct or indirect cost, and the newly

hired employee resigns for reasons within his control within twelve months after hire, the institution will be required to refund or credit such relocations costs as were charged to the Government.

35. *Rental costs (including sale and lease-back of facilities).* a. Rental costs of land, building, and equipment and other personal property are allowable if the rates are reasonable in light of such factors as rental costs of comparable facilities and market conditions in the area, the type, life expectancy, condition, and value of the facilities leased, options available, and other provisions of the rental agreement. Application of these factors, in situations where rentals are extensively used, may involve among other considerations comparison of rental costs with the amount which the hospital would have received had it owned the facilities.

b. Charges in the nature of rent between organizations having a legal or other affiliation or arrangement such as hospitals, medical schools, foundations, etc., are allowable to the extent such charges do not exceed the normal costs of ownership such as depreciation, taxes, insurance, and maintenance, provided that no part of such costs shall duplicate any other allowed costs.

c. Unless otherwise specifically provided in the agreement, rental costs specified in sale and lease-back agreements incurred by hospitals through selling plant facilities to investment organizations such as insurance companies or to private investors, and concurrently leasing back the same facilities are allowable only to the extent that such rentals do not exceed the amount which the hospital would have received had it retained legal title to the facilities.

36. *Royalties and other costs for use of patents.* Royalties on a patent or amortization of the cost of acquiring a patent or invention or rights thereto necessary for the proper performance of the research agreement and applicable to tasks or processes thereunder are allowable unless the Government has a license or the right to free use of the patent, the patent has been adjudicated to be invalid, or has been administratively determined to be invalid, the patent is considered to be unenforceable, or the patent has expired.

37. *Severance pay.* a. Severance pay is compensation in addition to regular salaries and wages which is paid by a hospital to employees whose services are being terminated. Costs of severance pay are allowable only to the extent that such payments are required by law, by employer-employee agreement, by established policy that constitutes in effect an implied agreement on the institution's part, or by circumstances of the particular employment.

b. Severance payments that are due to normal, recurring turnover, and which otherwise meet the conditions of (a) above may be allowed provided the actual costs of such severance payments are regarded as expenses applicable to the current fiscal year and are equitably distributed among the institution's activities during that period.

c. Severance payments that are due to abnormal or mass terminations are of such conjectural nature that allowability must be determined on a case-by-case basis. However, the Government recognizes its obligation to participate to the extent of its fair share in any specific payment.

38. *Specialized service facilities operated by a hospital.* a. The costs of institutional services involving the use of highly complex and specialized facilities such as electronic computers and reactors are allowable provided the charges therefor meet the conditions of (b) or (c) below, and otherwise take into account any items of income or federal financing that qualify as applicable credits under para. III-E.

b. The costs of such hospital services normally will be charged directly to applicable research agreements based on actual usage or occupancy of the facilities at rates that (1) are designed to recover only actual costs of providing such services, and (2) are applied on a nondiscriminatory basis as between organized research and other work of the hospital including commercial or accommodation sales and usage by the hospital for internal purposes. This would include use of such facilities as radiology, laboratories, maintenance men used for a special purpose, medical art, photography, etc.

c. In the absence of an acceptable arrangement for direct costing as provided in (b) above, the costs incurred for such institutional services may be assigned to research agreements as indirect costs, provided the methods used achieve substantially the same results. Such arrangements should be worked out in coordination with all government users of the facilities in order to assure equitable distribution of the indirect costs.

39. *Special administrative costs.* Costs incurred for general public relations activities, catalogs, alumni activities, and similar services are unallowable.

40. *Staff and or employee benefits.* a. Staff and/or employee benefits in the form of regular compensation paid to employees during periods of authorized absences from the job such as for annual leave, sick leave, military leave and the like are allowable provided such costs are absorbed by all hospital activities including organized research in proportion to the relative amount of time or effort actually devoted to each.

b. Staff benefits in the form of employer contributions or expenses for Social Security taxes, employee insurance, Workmen's Compensation insurance, the Pension Plan (see para. IX-B.25), hospital costs or remission of hospital charges to the extent of costs for individual employees or their families, and the like are allowable provided such benefits are granted in accordance with established hospital policies, and

provided such contributions and other expenses whether treated as indirect costs or an increment of direct labor costs are distributed to particular research agreements and other activities in a manner consistent with the pattern of benefits accruing to the individuals or groups of employees whose salaries and wages are chargeable to such research agreements and other activities.

41. Taxes. a. In general, taxes which the hospital is required to pay and which are paid or accrued in accordance with generally accepted accounting principles, and payments made to local governments in lieu of taxes which are commensurate with the local government services received are allowable except for (1) taxes from which exemptions are available to the hospital directly or which are available to the hospital based on an exemption afforded the Government and in the latter case when the sponsoring agency makes available the necessary exemption certificates, (2) special assessments on land which represent capital improvements, and (3) Federal Income Taxes.

b. Any refund of taxes, interest, or penalties, and any payment to the hospital of interest thereon attributable to taxes, interest or penalties, which were allowed as research agreement costs will be credited or paid to the Government in the manner directed by the Government provided any interest actually paid or credited to a hospital incident to a refund of tax, interest, and penalty will be paid or credited to the Government only to the extent that such interest accrued over the period during which the hospital had been reimbursed by the Government for the taxes, interest, and penalties.

42. *Transportation costs.* Costs incurred for inbound freight, express, cartage, postage and other transportation services relating either to goods purchased, in process, or delivered are allowable. When such costs can readily be identified with the items involved, they may be charged directly as transportation costs or added to the cost of such items. Where identification with the material received cannot readily be made, inbound transportation costs may be charged to the appropriate indirect cost accounts if the institution follows a consistent equitable procedure in this respect. Outbound freight, if reimbursable under the terms of the research agreement, should be treated as a direct cost.

43. *Travel costs.* a. Travel costs are the expenses for transportation, lodging, subsistence, and related items incurred by employees who are in travel status on official business of the hospital. Such costs may be charged on an actual basis, on a per diem or mileage basis in lieu of actual costs incurred, or on a combination of the two provided the method used is applied to an entire trip and not to selected days of the trip, and results in charges consistent with those normally allowed by the institution in its regular operations.

b. Travel costs are allowable subject to (c) and (d) below when they are directly attributable to specific work under a research agreement or when they are incurred in the normal course of administration of the hospital or a department or research program thereof.

c. The difference in cost between first class air accommodations and less than first class air accommodations is unallowable except when less than first class air accommodations are not reasonably available to meet necessary mission requirements such as where less than first class accommodations would (1) require circuitous routing, (2) require travel during unreasonable hours, (3) greatly increase the duration of the flight, (4) result in additional costs which would offset the transportation savings, or (5) offer accommodations which are not reasonably adequate for the medical needs of the traveler.

d. Costs of personnel movements of a special or mass nature are allowable only when authorized or approved in writing by the sponsoring agency or its authorized representative.

44. *Termination costs applicable to contracts.* a. Contract terminations generally give rise to the incurrence of costs or to the need for special treatment of costs which would not have arisen had the contract not been terminated. Items peculiar to termination are set forth below. They are to be used in conjunction with all other provisions of these principles in the case of contract termination.

b. The cost of common items of material reasonably usable on the hospital's other work will not be allowable unless the hospital submits evidence that it could not retain such items at cost without sustaining a loss. In deciding whether such items are reasonably usable on other work of the institution, consideration should be given to the hospital's plans for current scheduled work or activities including other research agreements. Contemporaneous purchases of common items by the hospital will be regarded as evidence that such items are reasonably usable on the hospital's other work. Any acceptance of common items as allowable to the terminated portion of the contract should be limited to the extent that the quantities of such items on hand, in transit, and on order are in excess of the reasonable quantitative requirement of other work.

c. If in a particular case, despite all reasonable efforts by the hospital, certain costs cannot be discontinued immediately after the effective date of termination, such costs are generally allowable within the limitations set forth in these principles, except that any such costs continuing after termination due to the negligent or willful failure of the hospital to discontinue such costs will be considered unacceptable.

d. Loss of useful value of special tooling and special machinery and equipment is generally allowable, pro-

vided (1) such special tooling, machinery or equipment is not reasonably capable of use in the other work of the hospital; (2) the interest of the Government is protected by transfer of title or by other means deemed appropriate by the contracting officer; and (3) the loss of useful value as to any one terminated contract is limited to that portion of the acquisition cost which bears the same ratio to the total acquisition cost as the terminated portion of the contract bears to the entire terminated contract and other government contracts for which the special tooling, special machinery or equipment was acquired.

e. Rental costs under unexpired leases are generally allowable where clearly shown to have been reasonably necessary for the performance of the terminated contract, less the residual value of such leases, if (1) the amount of such rental claimed does not exceed the reasonable use value of the property leased for the period of the contract and such further period as may be reasonable; and (2) the hospital makes all reasonable efforts to terminate, assign, settle, or otherwise reduce the cost of such lease. There also may be included the cost of alterations of such leased property, provided such alterations were necessary for the performance of the contract and of reasonable restoration required by the provisions of the lease.

f. Settlement expenses including the following are generally allowable: (1) accounting, legal, clerical, and similar costs reasonably necessary for the preparation and presentation to contracting officers of settlement claims and supporting data with respect to the terminated portion of the contract and the termination and settlement of subcontracts; and (2) reasonable costs for the storage, transportation, protection, and disposition of property provided by the Government or acquired or produced by the institution for the contract.

g. Subcontractor claims including the allocable portion of claims which are common to the contract and to other work of the contractor are generally allowable.

45. *Voluntary services.* The value of voluntary services provided by sisters or other members of religious orders is allowable provided that amounts do not exceed that paid other employees for similar work. Such amounts must be identifiable in the records of the hospital as a legal obligation of the hospital. This may be reflected by an agreement between the religious order and the hospital supported by evidence of payments to the order.

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48 CFR SUBPART 31.2

COST PRINCIPLES FOR FOR-PROFIT ORGANIZATIONS [OTHER THAN FOR-PROFIT HOSPITALS]

SUBPART 31.2—CONTRACTS WITH COMMERCIAL ORGANIZATIONS

31.201 General.

31.201-1 Composition of total cost.

The total cost of a contract is the sum of the allowable direct and indirect costs allocable to the contract, incurred or to be incurred, less any allocable credits, plus any allocable cost of money pursuant to 31.205-10. In ascertaining what constitutes a cost, any generally accepted method of determining or estimating costs that is equitable and is consistently applied may be used, including standard costs properly adjusted for applicable variances. See 31.201-2(b) and (c) for Cost Accounting Standards (CAS) requirements.

31.201-2 Determining allowability.

(a) The factors to be considered in determining whether a cost is allowable include the following:

(1) Reasonableness.

(2) Allocability.

(3) Standards promulgated by the CAS Board, if applicable; otherwise, generally accepted accounting

principles and practices appropriate to the particular circumstances.

(4) Terms of the contract.

(5) Any limitations set forth in this subpart.

(b) Certain cost principles in this subpart incorporate the measurement, assignment, and allocability rules of selected CAS and limit the allowability of costs to the amounts determined using the criteria in those selected standards. Only those CAS or portions of standards specifically made applicable by the cost principles in this subpart are mandatory unless the contract is CAS-covered (see Part 30). Business units that are not otherwise subject to these standards under a CAS clause are subject to the selected standards only for the purpose of determining allowability of costs on Government contracts. Including the selected standards in the cost principles does not subject the business unit to any other CAS rules and regulations. The applicability of the CAS rules and regulations is determined by the CAS clause, if any, in the contract and the requirements of the standards themselves.

(c) When contractor accounting practices are inconsistent with this Subpart 31.2, costs resulting from such inconsistent practices shall not be allowed in excess of the amount that would have resulted from using practices consistent with this subpart.

31.201-3 Determining reasonableness.

A cost is reasonable if, in its nature and amount, it does not exceed that which would be incurred by a prudent person in the conduct of competitive business. Reasonableness of specific costs must be examined with particular care in connection with firms or their separate divisions that may not be subject to effective competitive restraints. What is reasonable depends upon a variety of considerations and circumstances involving both the nature and amount of the cost in question. In determining the reasonableness of a specific cost, the contracting officer shall consider—

(a) Whether it is the type of cost generally recognized as ordinary and necessary for the conduct of the contractor's business or the contract performance;

(b) The restraints or requirements imposed by such factors as generally accepted sound business practices, arm's-length bargaining, Federal and State laws and regulations, and contract terms and specifications;

(c) The action that a prudent business person, considering responsibilities to the owners of the business, employees, customers, the Government, and the public at large, would take under the circumstances; and

(d) Any significant deviations from the established practices of the contractor that may unjustifiably increase the contract costs.

31.201-4 Determining allocability.

A cost is allocable if it is assignable or chargeable to one or more cost objectives on the basis of relative benefits received or other equitable relationship. Subject to the foregoing, a cost is allocable to a Government contract if it—

(a) Is incurred specifically for the contract;

(b) Benefits both the contract and other work, and can be distributed to them in reasonable proportion to the benefits received; or

(c) Is necessary to the overall operation of the business, although a direct relationship to any particular cost objective cannot be shown.

31.201-5 Credits.

The applicable portion of any income, rebate, allowance, or other credit relating to any allowable cost and received by or accruing to the contractor shall be credited to the Government either as a cost reduction or by cash refund.

31.201-6 Accounting for unallowable costs.

(a) Costs that are expressly unallowable or mutually agreed to be unallowable, including mutually agreed to be unallowable directly associated costs, shall be identified and excluded from any billing, claim, or proposal applicable to a Government contract. A directly associated cost is any cost which is generated solely as a result of incurring another cost, and which would not have been incurred had the other cost not been incurred. When an unallowable cost is incurred, its directly associated costs are also unallowable.

(b) Costs which specifically become designated as unallowable or as unallowable directly associated costs of unallowable costs as a result of a written decision furnished by a contracting officer shall be identified if included in or used in computing any billing, claim, or proposal applicable to a Government contract. This identification requirement applies also to any costs incurred for the same purpose under like circumstances as the costs specifically identified as unallowable under either this paragraph or paragraph (a) above.

(c) The detail and depth of records required as backup support for proposals, billings, or claims shall be that which is adequate to establish and maintain visibility of identified unallowable costs, including directly associated costs. Unallowable costs involved in determining rates used for standard costs, or for indirect cost proposals or billing, need be identified only at the time rates are proposed, established, revised, or adjusted. These requirements may be satisfied by any form of cost identification which is adequate for purposes of contract cost determination and verification.

(d) If a directly associated cost is included in a cost pool which is allocated over a base that includes the unallowable cost with which it is associated, the directly associated cost shall remain in the cost pool. Since the unallowable costs will attract their allocable share of costs from the cost pool, no further action is required to assure disallowance of the directly associated costs. In all other cases, the directly associated costs, if material in amount, must be purged from the cost pool as unallowable costs.

(e) (1) In determining the materiality of a directly associated cost, consideraton should be given to the significance of (i) the actual dollar amount, (ii) the cumulative effect of all directly associated costs in a cost pool, or (iii) the ultimate effect on the cost of Government contracts.

(2) Salary expenses of employees who participate in activities that generate unallowable costs shall be treated as directly associated costs to the extent of the time spent on the proscribed activity, provided the costs are material in accordance with subparagraph (e)(1) above (except when such salary expenses are, themselves, unallowable). The time spent in proscribed activities should be compared to total time spent on company activities to determine if the costs are material. Time spent by employees outside the normal working hours should not be considered except when it is evident that an employee engages so frequently in company activities during periods outside normal working hours as to indicate that such activities are a part of the employee's regular duties.

(3) When a selected item of cost under 31.205 provides that directly associated costs be unallowable, it is intended that such directly associated costs be unallowable only if determined to be material in amount in accordance with the criteria provided in subparagraphs (e)(1) and (e)(2) above, except in those situations where allowance of any of the directly associated costs involved would be considered to be contrary to public policy.

31.201-7 Construction and architect-engineer contracts.

Specific principles and procedures for evaluating and determining costs in connection with contracts and subcontracts for construction, and architect-engineer contracts related to construction projects, are in 31.105. The applicability of these principles and procedures is set forth in 31.000 and 31.100.

31.202 Direct costs.

(a) A direct cost is any cost that can be identified specifically with a particular final cost objective. No final cost objective shall have allocated to it as a direct cost any cost, if other costs incurred for the same purpose in like circumstances have been included in any indirect cost pool to be allocated to that or any other final cost objective. Costs identified specifically with the contract are direct costs of the contract and are to be charged directly to the contract. All costs specifically identified with other final cost objectives of the contractor are direct costs of those cost objectives and are not to be charged to the contract directly or indirectly.

(b) For reasons of practicality, any direct cost of minor dollar amount may be treated as an indirect cost if the accounting treatment—

(1) Is consistently applied to all final cost objectives; and

(2) Produces substantially the same results as treating the cost as a direct cost.

31.203 Indirect costs.

(a) An indirect cost is any cost not directly identified with a single, final cost objective, but identified with two or more final cost objectives or an intermediate cost objective. It is not subject to treatment as a direct cost. After direct costs have been determined and charged directly to the contract or other work, indirect costs are those remaining to be allocated to the several cost objectives. An indirect cost shall not be allocated to a final cost objective if other costs incurred for the same purpose in like circumstances have been included as a direct cost of that or any other final cost objective.

(b) Indirect costs shall be accumulated by logical cost groupings with due consideration of the reasons for incurring such costs. Each grouping should be determined so as to permit distribution of the grouping on the basis of the benefits accruing to the several cost objectives. Commonly, manufacturing overhead, selling expenses, and general and administrative (G&A) expenses are separately grouped. Similarly, the particular case may require subdivision of these groupings, e.g., building occupancy costs might be separable from those of personnel administration within the manufacturing overhead group. This necessitates selecting a distribution base common to all cost objectives to which the grouping is to be allocated. The base should be selected so as to permit allocation of the grouping on the basis of the benefits accruing to the several cost objectives. When substantially the same results can be achieved through less precise methods, the number and composition of cost groupings should be governed by practical considerations and should not unduly complicate the allocation.

(c) Once an appropriate base for distributing indirect costs has been accepted, it shall not be fragmented by removing individual elements. All items properly includable in an indirect cost base should bear a pro rata share of indirect costs irrespective of their acceptance as Government contract costs. For example, when a cost input base is used for the distribution of G&A costs, all items that would properly be part of the cost input base, whether allowable or unallowable, shall be included in the base and bear their pro rata share of G&A costs.

(d) The contractor's method of allocating indirect costs shall be in accordance with standards promulgated by the CAS Board, if applicable to the contract; otherwise, the method shall be in accordance with generally accepted accounting principles which are consistently applied. The method may require examination when—

(1) Substantial differences occur between the cost patterns of work under the contract and the contractor's other work;

(2) Significant changes occur in the nature of the business, the extent of subcontracting, fixed-asset improvement programs, inventories, the volume of sales and production, manufacturing processes, the contractor's products, or other relevant circumstances; or

(3) Indirect cost groupings developed for a contractor's primary location are applied to offsite locations. Separate cost groupings for costs allocable to offsite locations may be necessary to permit equitable distribution of costs on the basis of the benefits accruing to the several cost objectives.

(e) A base period for allocating indirect costs is the cost accounting period during which such costs are incurred and accumulated for distribution to work performed in that period. The criteria and guidance in CAS 406 for selecting the cost accounting periods to be used in allocating indirect costs are incorporated herein for application to contracts subject to full CAS coverage. For contracts subject to modified CAS coverage and for non-CAS-covered contracts, the base period for allocating indirect costs will normally be the contractor's fiscal year. But a shorter period may be appropriate (1) for contracts in which performance involves only a minor portion of the fiscal year or (2) when it is general practice in the industry to use a shorter period. When a contract is performed over an extended period, as many base periods shall be used as are required to represent the period of contract performance.

(f) Special care should be exercised in applying the principles of paragraphs (b), (c), and (d) above when Government-owned contractor-operated (GOCO) plants are involved. The distribution of corporate, division, or branch office G&A expenses to such plants operating with little or no dependence on corporate administrative activities may require more precise cost groupings, detailed accounts screening, and carefully developed distribution bases.

31.204 Application of principles and procedures.

(a) Costs shall be allowed to the extent they are reasonable, allocable, and determined to be allowable under 31.201, 31.202, 31.203, and 31.205. These criteria apply to all of the selected items that follow, even if particular guidance is provided for certain items for emphasis or clarity.

(b) Costs incurred as reimbursements or payments to a subcontractor under a cost-reimbursement, fixed-price incentive, or price redeterminable type subcontract of any tier above the first firm-fixed-price subcontract or fixed-price subcontract with economic price adjustment provisions are allowable to the extent that allowance is consistent with the appropriate subpart of this Part 31 applicable to the subcontract involved. Costs incurred as payments under firm-fixed-price subcontracts or fixed-price subcontracts with economic price adjustment provisions or modifications thereto, when cost analysis was performed under 15.805-3, shall be allowable only to the extent that the price was negotiated in accordance with 31.102.

(c) Section 31.205 does not cover every element of cost. Failure to include any item of cost does not imply that it is either allowable or unallowable. The determination of allowability shall be based on the principles and standards in this subpart and the treatment of similar or related selected items.

31.205 Selected costs.

31.205-1 Advertising costs.

(a) "Advertising costs" means the costs of advertising and directly associated costs, regardless of the medium employed, when the advertiser has control over the form and content of what will appear, the media in which it will appear, and when it will appear. Advertising media includes conventions, exhibits, free goods, samples, magazines, newspapers, trade papers, direct mail, dealer cards, window displays, outdoor advertising, and radio and television programs.

(b) The only advertising costs allowable are those that arise from requirements of Government contracts and that are for—

(1) Recruiting personnel required for performing contractual obligations, when considered in conjunction with all other recruitment costs (but see 31.205-34);

(2) Acquiring scarce items for contract performance; or

(3) Disposing of scrap or surplus materials acquired for contract performance.

Costs of this nature, if incurred for more than one defense contract or both defense work and other work of the contractor, are allowable to the extent that the principles in 31.201-3, 31.201-4, and 31.203 are observed.

(c) Advertising costs other than those specified in paragraph (b) above are unallowable. Unallowable advertising costs include those related to sales promotion which involve direct payment for using time or space to promote the sale of products, either directly by stimulating interest in a product or product line, or indirectly by disseminating messages calling favorable attention to the advertiser for purposes of enhancing the overall company image to sell the company's products.

31.205-2 Automatic data processing equipment leasing costs.

(a) This subsection applies to all contractor-leased automatic data processing equipment (ADPE), as defined in 31.001 (except as components of an end item to be delivered to the Government), acquired under operating leases, as defined in Statement of Financial Accounting Standard No. 13 (FAS-13), Accounting for Leases, issued by the Financial Accounting Standards Board. Compliance with 31.205-11(m) requires that

ADPE acquired by means of capital leases, as defined in FAS-13, shall be treated as purchased assets; i.e., be capitalized and the capitalized value of such assets be distributed over their useful lives as depreciation charges or over the leased life as amortization charges as appropriate. Allowability of costs related to contractor-owned ADPE is governed by other requirements of this subpart.

(b) (1) If the contractor leases ADPE but cannot demonstrate, on the basis of facts existent at the time of the decision to lease or continue leasing and documented in accordance with paragraph (d) below, that leasing will result in less cost to the Government over the anticipated useful life (see paragraph (c) below), then rental costs are allowable only up to the amount that would be allowed had the contractor purchased the ADPE.

(2) The costs of leasing ADPE are allowable only to the extent that the contractor can annually demonstrate in accordance with paragraph (d) below (whether or not the term of lease is renewed or otherwise extended) that these costs meet the following criteria:

(i) The costs are reasonable and necessary for the conduct of the contractor's business in light of factors such as the contractor's requirements for ADPE, costs of comparable facilities, the various types of leases available, and the terms of the rental agreement.

(ii) The costs do not give rise to a material equity in the facilities (such as an option to renew or purchase at a bargain rental or price other than that normally given to industry at large) but represent charges only for the current use of the equipment, including incidental service costs such as maintenance, insurance, and applicable taxes.

(iii) The contracting officer's approval was obtained for the leasing arrangement (see subparagraph (d)(3) below) when the total cost of leasing—

(A) The ADPE is to be allocated to one or more Government contracts which require negotiating or determining costs, or

(B) ADPE in a single plant, division, or cost center exceeds $500,000 a year and 50 percent or more of the total leasing cost is to be allocated to one or more Government contracts which require negotiating or determining costs.

(3) Rental costs under a sale and leaseback arrangement are allowable only up to the amount that would have been allowed had the contractor retained title to the ADPE.

(4) Allowable rental costs of ADPE leased from any division, subsidiary, or organization under a common control are limited to the cost of ownership (excluding interest or other costs unallowable under this Subpart 31.2 and including the cost of money (see 31.205-10)). When there is an established practice of leasing the same or similar equipment to unaffiliated lessees, rental costs shall be allowed in accordance with subparagraphs (b)(1) and (2) above, except that the purchase price and costs of ownership shall be determined under 31.205-26(e).

(c) (1) An estimate of the anticipated useful life of the ADPE may represent the application life (utility in a given function), technological life (utility before becoming obsolete in whole or in part), or physical life (utility before wearing out) depending upon the facts and circumstances and the particular facilities involved. Each case must be evaluated individually. In estimating anticipated useful life, the contractor may use the application life if it can be demonstrated that the ADPE has utility only in a given function and the duration of the function can be determined. Technological life may be used if the contractor can demonstrate that existing ADPE must be replaced because of—

(i) Specific program objectives or contract requirements that cannot be accomplished with the existing ADPE;

(ii) Cost reductions that will produce identifiable savings in production or overhead costs;

(iii) Increase in workload volume that cannot be accomplished efficiently by modifying or augmenting existing ADPE; or

(iv) Consistent pattern of capacity operation (2 ½-3 shifts) on existing ADPE.

(2) Technological advances will not justify replacing existing ADPE before the end of its physical life if it will be able to satisfy future requirements or demands.

(3) In estimating the least cost to the Government for useful life, the cumulative costs that would be allowed if the contractor owned the ADPE should be compared with cumulative costs that would be allowed under any of the various types of leasing arrangements available. For the purpose of this comparison, the costs of ADPE exclude interest or other unallowable costs pursuant to this Subpart 31.2; they include but are not limited to the costs of operation, maintenance, insurance, depreciation, facilities capital cost of money, rental, and the cost of machine services, as applicable.

(d) (1) Except as provided in subparagraph (3) below, the contractor's justification, under paragraph (b) above, of the leasing decisions shall consist of the following supporting data, prepared before acquisition:

(i) Analysis of use of existing ADPE.

(ii) Application of the criteria in paragraph (b) above.

(iii) Specific objectives or requirements, generally in the form of a data system study and specification.

(iv) Solicitation of proposals, based on the data system specification, from qualified sources.

(v) Proposals received in response to the solicitation and reasons for selecting the equipment chosen and for the decision to lease.

(2) Except as provided in subparagraph (3) below, the contractor's annual justification, under subparagraph (b)(2) above, of the decision to retain or change existing ADPE capability and the need to continue leasing shall consist of current data as specified in subdivisions (d)(1)(i) through (iii) above.

(3) If the contractor's prospective ADPE lease cost meets the threshold in 31.205-2(b)(2)(iii) above, the contractor shall furnish data supporting the initial decision to lease (see subparagraph (b)(1) above). If the total cost of leasing ADPE in a single plant, division, or cost center exceeds $500,000 per year and 50 percent or more of the total leasing cost is allocated to Government contracts which require negotiating or determining costs, the contractor shall furnish data supporting the annual justification for retaining or changing existing ADPE capability and the need to continue leasing shall also be furnished (see subparagraph (b)(2) above).

31.205-3 Bad debts.

Bad debts, including actual or estimated losses arising from uncollectible accounts receivable due from customers and other claims, and any directly associated costs such as collection costs, and legal costs are unallowable.

31.205-4 Bonding costs.

(a) Bonding costs arise when the Government requires assurance against financial loss to itself or others by reason of the act or default of the contractor. They arise also in instances where the contractor requires similar assurance. Included are such bonds as bid, performance, payment, advance payment, infringement, and fidelity bonds.

(b) Costs of bonding required pursuant to the terms of the contract are allowable.

(c) Costs of bonding required by the contractor in the general conduct of its business are allowable to the extent that such bonding is in accordance with sound business practice and the rates and premiums are reasonable under the circumstances.

31.205-5 Civil defense costs.

(a) Civil defense costs are those incurred in planning for, and protecting life and property against, the possible effects of enemy attack. Costs of civil defense measures (including costs in excess of normal plant protection costs, first-aid training and supplies, fire fighting training and equipment, posting of additional exit notices and directions, and other approved civil defense measures) undertaken on the contractor's premises pursuant to suggestions or requirements of civil defense authorities are allowable when allocated to all work of the contractor.

(b) Costs of capital assets acquired for civil defense purposes are allowable through depreciation (see 31.205-11).

(c) Contributions to local civil defense funds and projects are unallowable.

31.205-6 Compensation for personal services.

(a) *General.* Compensation for personal services includes all remuneration paid currently or accrued, in whatever form and whether paid immediately or deferred, for services rendered by employees to the contractor during the period of contract performance (except as otherwise provided for severance pay costs in paragraph (g) below and for pension costs in paragraph (j) below). It includes, but is not limited to, salaries; wages; directors' and executive committee members' fees; bonuses (including stock bonuses); incentive awards; employee stock options, stock appreciation rights, and stock ownership plans; employee insurance; fringe benefits; contributions to pension, annuity, and management employee incentive compensation plans; and allowances for off-site pay, incentive pay, location allowances, hardship pay, severance pay, and cost of living differential. Compensation for personal services is allowable subject to the following general criteria and additional requirements contained in other parts of this cost principle:

(1) Compensation for personal services must be for work performed by the employee in the current year and must not represent a retroactive adjustment of prior years' salaries or wages (but see 31.205-6(g), (h), (j), (k), and (m) below).

(2) The compensation in total must be reasonable for the work performed; however, specific restrictions on individual compensation elements must be observed where they are prescribed.

(3) The compensation must be based upon and conform to the terms and conditions of the contractor's established compensation plan or practice followed so consistently as to imply, in effect, an agreement to make the payment.

(4) No presumption of allowability will exist where the contractor introduces major revisions of existing compensation plans or new plans and the contractor—

(i) Has not notified the cognizant ACO of the changes either before their implementation or within a reasonable period after their implementation, and

(ii) Has not provided the Government, either before implementation or within a reasonable period after it, an opportunity to review the allowability of the changes.

(5) Costs that are unallowable under other paragraphs of this Subpart 31.2 shall not be allowable under this subsection 31.205-6 solely on the basis that they constitute compensation for personal services. (See 31.205-34(c.))

(b) *Reasonableness.* Compensation for personal services will be considered reasonable if the total compensation conforms generally to compensation paid by other firms of the same size, in the same industry, or in the same geographic area for similar services or work performed. This does not preclude the Government from challenging the reasonableness of an individual element of compensation where costs are excessive in comparison with compensation paid by other firms of the same size, same industry, or in the same geographic area for similar services. In administering this principle, it is recognized that not every compensation case need be subjected in detail to the above tests. The tests need be applied only when a general review reveals amounts or types of compensation that appear unreasonable or unjustified. In questionable cases, the contractor has responsibility to support the reasonableness of the compensation in relation to the effort performed. Compensation costs under certain conditions give rise to the need for special consideration. Among such conditions are the following:

(1) Compensation to (i) owners of closely held corporations, partners, sole proprietors, or members of their immediate families, or (ii) persons who are contractually committed to acquire a substantial financial interest in the contractor's enterprise. Determination should be made that salaries are reasonable for the personal services rendered rather than being a distribution of profits. Compensation in lieu of salary for services rendered by partners and sole proprietors will be allowed to the extent that it is reasonable and does not constitute a distribution of profits. For closely held corporations, compensation costs covered by this subparagraph shall not be recognized in amounts exceeding those costs that are deductible as compensation under the Internal Revenue Code and regulations under it.

(2) Any change in a contractor's compensation policy that results in a substantial increase in the contractor's level of compensation, particularly when it was concurrent with an increase in the ratio of Government contracts to other business, or any change in the treatment of allowability of specific types of compensation due to changes in Government policy. No presumption of reasonableness will exist where major revisions of existing compensation plans or new plans are introduced by the contractor; and the contractor—

(i) Has not notified the cognizant ACO of the change either before their implementation or within a reasonable period after their implementation; and

(ii) Has not provided the Government, either before implementation or within a reasonable period after it, an opportunity to review the reasonableness of the changes.

(3) The contractor's business is such that its compensation levels are not subject to the restraints that normally occur in the conduct of competitive business.

(4) The contractor incurs costs for compensation in excess of the amounts which are deductible under the Internal Revenue Code and regulations issued under it.

(c) *Labor-management agreements.* Nothwithstanding any other requirements of this subsection 31.205-6, costs of compensation are not allowable to the extent that they result from provisions of labor-management agreements that, as applied to work in performing Government contracts, are determined to be unreasonable because they are either unwarranted by the character and circumstances of the work or discriminatory against the Government. The application of the provisions of a labor-management agreement designed to apply to a given set of circumstances and conditions of employment (e.g., work involving extremely hazardous activities or work not requiring recurrent use of overtime) is unwarranted when applied to a Government contract involving significantly different circumstances and conditions of employment (e.g., work involving less hazardous activities or work continually requiring use of overtime). It is discriminatory against the Government if it results in employee compensation (in whatever form or name) in excess of that being paid for similar non-Government work under comparable circumstances. Disallowance of costs will not be made under this paragraph (c) unless—

(1) The contractor has been permitted an opportunity to justify the costs; and

(2) Due consideration has been given to whether unusual conditions pertain to Government contract work, imposing burdens, hardships, or hazards on the contractor's employees, for which compensation that might otherwise appear unreasonable is required to attract and hold necessary personnel.

(d) *Salaries and wages.* Salaries and wages for current services include gross compensation paid to employees in the form of cash, stock (see subparagraph (f)(2) below regarding valuation), products, or services, and are allowable.

(e) *Domestic and foreign differential pay.* (1) When personal services are performed in a foreign country, compensation may also include a differential that may properly consider all expenses associated with foreign employment such as housing, cost of living adjustments, transportation, bonuses, additional Federal, State, local or foreign income taxes resulting from foreign assignment, and other related expenses.

(2) Although the additional taxes in subparagraph (1) above may be considered in establishing foreign overseas differential, any increased compensation calculated directly on the basis of an employee's specific increase in income taxes is unallowable. Differential allowances for additional Federal, State, or local

income taxes resulting from domestic assignments are unallowable.

(f) *Bonuses and incentive compensation.* (1) Incentive compensation for management employees, cash bonuses, suggestion awards, safety awards, and incentive compensation based on production, cost reduction, or efficient performance are allowable provided the awards are paid or accrued under an agreement entered into in good faith between the contractor and the employees before the services are rendered or pursuant to an established plan or policy followed by the contractor so consistently as to imply, in effect, an agreement to make such payment and the basis for the award is supported.

(2) When the costs of bonuses and incentive compensation are paid in the stock of the contractor or of an affiliate, the following additional restrictions apply:

(i) Valuation placed on the stock shall be the fair market value on the measurement date (i.e., the first date the number of shares awarded is known) determined upon the most objective basis available; and

(ii) Accruals for the cost of stock before issuing the stock to the employees shall be subject to adjustment according to the possibilities that the employees will not receive the stock and that their interest in the accruals will be forfeited.

(3) When the bonus and incentive compensation payments are deferred, the costs are subject to the requirements of subparagraph (f)(1) above and of paragraph (k) below.

(g) *Severance pay.* (1) Severance pay, also commonly referred to as dismissal wages, is a payment in addition to regular salaries and wages by contractors to workers whose employment is being involuntarily terminated. Payments for early retirement incentive plans are covered in subparagraph (j)(6) below.

(2) Severance pay to be allowable must meet the general allowability criteria in subdivision (g)(2)(i) below, and, depending upon whether the severance is normal or abnormal, criteria in subdivision (g)(2)(ii) for normal severance pay or subdivision (g)(2)(iii) for abnormal severance pay also apply.

(i) Severance pay is allowable only to the extent that, in each case, it is required by (A) law, (B) employer-employee agreement, (C) established policy that constitutes, in effect, an implied agreement on the contractor's part, or (D) circumstances of the particular employment. Payments made in the event of employment with a replacement contractor where continuity of employment with credit for prior length of service is preserved under substantially equal conditions of employment, or continued employment by the contractor at another facility, subsidiary, affiliate, or parent company of the contractor are not severance pay and are unallowable. Severance payments, or amounts paid in lieu thereof, are not allowable when paid to employees in addition to early or normal retirement payments.

(ii) Actual normal turnover severance payments shall be allocated to all work performed in the contractor's plant, or where the contractor provides for accrual of pay for normal severances, that method will be acceptable if the amount of the accrual is reasonable in light of payments actually made for normal severances over a representative past period and if amounts accrued are allocated to all work performed in the contractor's plant.

(iii) Abnormal or mass severance pay is of such a conjectural nature that measurement of costs by means of an accrual will not achieve equity to both parties. Thus, accruals for this purpose are not allowable. However, the Government recognizes its obligation to participate, to the extent of its fair share, in any specific payment. Thus, allowability will be considered on a case-by-case basis.

(h) *Backpay.* (1) *Backpay resulting from violations of Federal labor laws or the Civil Rights Act of 1964.* Backpay may result from a negotiated settlement, order, or court decree that resolves a violation of Federal labor laws or the Civil Rights Act of 1964. Such backpay falls into two categories: one requiring the contractor to pay employees additional compensation for work performed for which they were underpaid, and the other resulting from other violations, such as when the employee was improperly discharged, discriminated against, or other circumstances for which the backpay was not additional compensation for work performed. Backpay resulting from underpaid work is compensation for the work performed and is allowable. All other backpay resulting from violation of Federal labor laws or the Civil Rights Act of 1964 is unallowable.

(2) *Other backpay.* Backpay may also result from payments to union employees (union and non-union) for the difference in their past and current wage rates for working without a contract or labor agreement during labor management negotiations. Such backpay is allowable. Backpay to nonunion employees based upon results of union agreement negotiations is allowable only if (i) a formal agreement or understanding exists between management and the employees concerning these payments, or (ii) an established policy or practice exists and is followed by the contractor so consistently as to imply, in effect, an agreement to make such payment.

(i) *Stock options, stock appreciation rights, and phantom stock plans.* (1) The cost of stock options awarded to employees to purchase stock of the contractor or of an affiliate will be treated as deferred compensation and must comply with the requirements of paragraph (k) below and with the allowability criteria contained

in subparagraph (i)(2) below. The allowable cost of stock appreciation rights, whether offered separately or combined with stock options, will be determined in the same manner as stock options.

(2) The allowable costs of stock options and stock appreciation rights will be limited to the difference between the option price or stock-appreciation-right price and the market price of the stock on the measurement date (i.e., the first date on which both the number of shares and the option or stock-appreciation-right price are known). Accordingly, when the option or stock-appreciation-right price is equal to or greater than the market price on the measurement date, then no costs are allowed for contract costing purposes.

(3) In phantom-stock-type plans, contractors assign or attribute contingent shares of stock to employees as if the employees own the stock, even though the employees neither purchase the stock nor receive title to it. Under these plans, an employee's account may be increased by the equivalent of dividends issued and any appreciation in the market price of the stock over the price of the stock on the measurement date (i.e., the first date the number of shares awarded is known). Such increases in employee accounts for dividend equivalents and market price appreciation are unallowable.

(j) *Pension costs.* (1) A pension plan is a deferred compensation plan that is established and maintained by one or more employers to provide systematically for paying benefits to plan participants after their retirement, provided that the benefits are paid for life or are payable for life at the option of the employee. Additional benefits such as permanent and total disability and death payments and survivorship payments to beneficiaries of deceased employees may be treated as pension costs, provided the benefits are an integral part of the pension plan and meet all the criteria pertaining to pension costs.

(2) Pension plans are normally segregated into two types of plans: defined benefit or defined contribution pension plans. The cost of all defined benefit pension plans shall be measured, allocated, and accounted for in compliance with the provisions of CAS 412, Composition and Measurement of Pension Costs, and CAS 413, Adjustment and Allocation of Pension Cost. The costs of all defined contribution pension plans shall be measured, allocated, and accounted for in accordance with the provisions of CAS 412. Pension costs are allowable subject to the referenced standards and the cost limitations and exclusions set forth below in this subparagraph and in subparagraphs (j)(3), (4), (5), (6), and (7) below.

(i) To be allowable in the current year, pension costs must be funded by the time set for filing the Federal income tax return or any extension thereof. Pension costs assigned to the current year, but not funded by the tax return time, shall not be allowable in any subsequent year.

(ii) Pension payments must be reasonable in amount and be paid pursuant to (A) an agreement entered into in good faith between the contractor and employees before the work or services are performed and (B) the terms and conditions of the established plan. The cost of changes in pension plans which are discriminatory to the Government or are not intended to be applied consistently for all employees under similar circumstances in the future are not allowable.

(iii) Except as provided for early retirement benefits in subparagraph (j)(6) below, one-time-only pension supplements not available to all participants of the basic plan are not allowable as pension costs unless the supplemental benefits represent a separate pension plan and the benefits are payable for life at the option of the employee.

(iv) Increases in payments to previously retired plan participants covering cost-of-living adjustments are allowable if paid in accordance with a policy or practice consistently followed.

(3) *Defined benefit pension plans.* This subparagraph covers pension plans in which the benefits to be paid or the basis for determining such benefits are established in advance and the contributions are intended to provide the stated benefits. The cost limitations and exclusions pertaining to defined benefit plans are as follows:

(i) Normal costs of pension plans not funded in the year incurred, and all other components of pension costs (see CAS 412.40(a)(1)) assignable to the current accounting period but not funded during it, shall not be allowable in subsequent years (except that a payment made to a fund by the time set for filing the Federal income tax return or any extension thereof is considered to have been made during such taxable year). However, any part of a pension cost that is computed for a cost accounting period that is deferred pursuant to a waiver granted under the provisions of the Employee's Retirement Income Security Act of 1974 (ERISA) (see CAS 412.50(c)(3)), will be allowable in those future accounting periods in which the funding does occur. The allowability of these deferred contributions will be limited to the amounts that would have been allowed had the funding occurred in the year the costs would have been assigned except for the waiver.

(ii) Any amount paid or funded before the time it becomes assignable and allowable shall be applied to future years, in order of time, as if actually paid and deductible in those years. The interest earned on such premature funding, based on the valuation rate of return, may be excluded from

future years' computations of pension costs in accordance with CAS 412.50(a)(7).

(iii) Increased pension costs caused by delay in funding beyond 30 days after each quarter of the year to which they are assignable are unallowable. If a composite rate is used for allocating pension costs between the segments of a company and if, because of differences in the timing of the funding by the segments, an inequity exists, allowable pension costs for each segment will be limited to that particular segment's calculation of pension costs as provided for in CAS 413.50(c)(5). Determination of unallowable costs shall be made in accordance with the actuarial method used in calculating pension costs.

(iv) Allowability of the cost of indemnifying the Pension Benefit Guaranty Corporation (PBGC) under ERISA Section 4062 or 4064 arising from terminating an employee deferred compensation plan will be considered on a case-by-case basis; provided that if insurance was required by the PBGC under ERISA Section 4023, it was so obtained and the indemnification payment is not recoverable under the insurance. Consideration under the foregoing circumstances will be primarily for the purpose of appraising the extent to which the indemnification payment is allocable to Government work. If a beneficial or other equitable relationship exists, the Government will participate, despite the requirements of 31.205-19(a)(3) and (b), in the indemnification payment to the extent of its fair share.

(4) *Defined contribution pension plans.* This subparagraph covers those pension plans in which the contributions to be made are established in advance and the level of benefits is determined by the contributions made. It also covers profit sharing, savings plans, and other such plans provided the plans fall within the definition of a pension plan in subparagraph (j)(1) above.

(i) The pension cost assignable to a cost accounting period is the net contribution required to be made for that period after taking into account dividends and other credits, where applicable. However, any portion of pension cost computed for a cost accounting period that is deferred pursuant to a waiver granted under the provisions of ERISA (see CAS 412.50(c)(3)) will be allowable in those future accounting periods when the funding does occur. The allowability of these deferred contributions will be limited to the amounts that would have been allowed had the funding been made in the year the costs would have been assigned except for the waiver.

(ii) Any amount paid or funded to the trust before the time it becomes assignable and allowable shall be applied to future years, in order of time, as if actually paid and deductible in such years.

(iii) The provisions of subdivision (j)(3)(iv) above concerning payments to PBGC apply to defined contribution plans.

(5) *Pension plans using pay-as-you-go methods.* A pension plan using pay-as-you-go methods is a plan in which the contractor recognizes pension cost only when benefits are paid to retired employees or their beneficiaries. Regardless of whether the payment of pension benefits contribution can or cannot be compelled, allowable costs for these types of plans shall not exceed an amount computed as follows:

(i) Compute, by using an actuarial cost method, the plan's actuarial liability for benefits earned by plan participants. This entire liability is always unfunded for a pay-as-you-go plan.

(ii) Compute a level amount which, including an interest equivalent, would amortize the unfunded actuarial liability over a period of no less than 10 or more than 40 years from the inception of the liability.

(iii) Compute, by using an actuarial cost method, a normal cost for the period.

(iv) The sum of (ii) and (iii) above represents the amount of pension costs assignable to the current period. This amount, however, is limited to the amount paid in the year.

(v) For purposes of determining contract cost where a pay-as-you-go plan is initiated as either a supplemental plan or an additional but separate plan to a basic funded plan, the plans will be treated as one plan; e.g., the actuarial cost method, past service amortization period, etc., of the basic plan will be used on the supplemental or additional pay-as-you-go plan in determining the proper costs assignable to the current period. Any costs in excess of those determined by using the actuarial cost method and assumptions of the basic plan are unallowable. However, where assumption for salary progressions, mortality rates of the participants, and so forth are significantly different, the assumptions used for the basic and supplemental plan may be different.

(vi) The requirements of subdivisions (j)(3)(i) through (iv) above are also applicable to pay-as-you-go plans.

(6) *Early retirement incentive plans.* An early retirement incentive plan is a plan under which employees receive a bonus or incentive, over and above the requirement of the basic pension plan, to retire early. These plans normally are not applicable to all participants of the basic plan and do not represent life income settlements, and as such would not qualify as pension costs. However, for contract costing purposes, early retirement incentive payments are allow-

able subject to the pension cost criteria contained in subdivisions (j)(3)(i) through (iv) provided—

(i) The costs are accounted for and allocated in accordance with the contractor's system of accounting for pension costs (see subdivision (j)(5)(v) above for supplemental pension benefits);

(ii) The payments are made in accordance with the terms and conditions of the contractor's plan;

(iii) The plan is applied only to active employees. The cost of extending the plan to employees who retired or were terminated before the adoption of the plan is unallowable; and

(iv) The total of the incentive payments to any employee may not exceed the amount of the employee's annual salary for the previous fiscal year before the employee's retirement.

(7) *Employee stock ownership plans (ESOP)* (i) An ESOP is an individual stock bonus plan designed specifically to invest in the stock of the employer corporation. The contractor's contributions to an Employee Stock Ownership Trust (ESOT) may be in the form of cash, stock, or property. Costs of ESOP's are allowable subject to the following conditions:

(A) Contributions by the contractor in any one year may not exceed 15 percent (25 percent when a money purchase plan is included) of salaries and wages of employees participating in the plan in any particular year.

(B) The contribution rate (ratio of contribution to salaries and wages of participating employees) may not exceed the last approved contribution rate except when approved by the contracting officer based upon justification provided by the contractor. When no contribution was made in the previous year for an existing ESOP, or when a new ESOP is first established, and the contractor proposes to make a contribution in the current year, the contribution rate shall be subject to the contracting officer's approval.

(C) When a plan or agreement exists wherein the liability for the contribution can be compelled for a specific year, the expense associated with that liability is assignable only to that period. Any portion of the contribution not funded by the time set for filing of the Federal income tax return for that year or any extension thereof shall not be allowable in subsequent years.

(D) When a plan or agreement exists wherein the liability for the contribution cannot be compelled, the amount contributed for any year is assignable to that year provided the amount is funded by the time set for filing of the Federal income tax return for that year.

(E) When the contribution is in the form of stock, the value of the stock contribution shall be limited to the fair market value of the stock on the date that title is effectively transferred to the trust. Cash contributions shall be allowable only when the contractor furnishes evidence satisfactory to the contracting officer demonstrating that stock purchases by the ESOT are or will be at a fair market price; e.g., makes arrangements with the trust permitting the contracting officer to examine purchases of stock by the trust to determine that prices paid are at fair market value. When excessive prices are paid, the amount of the excess will be credited to the same indirect cost pools that were charged for the ESOP contributions in the year in which the stock purchase occurs. However, when the trust purchases the stock with borrowed funds which will be repaid over a period of years by cash contributions from the contractor to the trust, the excess price over fair market value shall be credited to the indirect cost pools pro rata over the period of years during which the contractor contributes the cash used by the trust to repay the loan. When the fair market value of unissued stock or stock of a closely held corporation is not readily determinable, the valuation will be made on a case-by-case basis taking into consideration the guidelines for valuation used by the IRS.

(ii) Amounts contributed to an ESOP arising from either (A) an additional investment tax credit (see 1975 Tax Reduction Act—TRASOP's); or (B) a payroll-based tax credit (see Economic Recovery Tax Act of 1981) are unallowable.

(iii) The requirements of subdivision (j)(3)(ii) above are applicable to Employee Stock Ownership Plans.

(k) *Deferred compensation.* (1) Deferred compensation is an award given by an employer to compensate an employee in a future cost accounting period or periods for services rendered in one or more cost accounting periods before the date of receipt of compensation by the employee. Deferred compensation does not include the amount of year-end accruals for salaries, wages, or bonuses that are paid within a reasonable period of time after the end of a cost accounting period. Subject to 31.205-6(a), deferred awards are allowable when they are based on current or future services. Awards made in periods subsequent to the period when the work being remunerated was performed are not allowable.

(2) The costs of deferred awards shall be measured, allocated, and accounted for in compliance with the provisions of CAS 415, Accounting for the Cost of Deferred Compensation.

(3) Deferred compensation payments to employees under awards made before the effective date of CAS 415 are allowable to the extent they would have been allowable under prior acquisition regulations.

(l) Reserved.

(m) *Fringe benefits.* Fringe benefits are allowances and services provided by the contractor to its employees as compensation in addition to regular wages and salaries. The cost of fringe benefits, including, but not limited to, the cost of vacations, sick leave, holidays, military leave, employee insurance, and supplemental unemployment benefit plans, is allowable if reasonable. The costs of fringe benefits are allowable to the extent that they are required by law, employer-employee agreement, or as an established policy of the contractor.

31.205-7 Contingencies.

(a) "Contingency," as used in this subpart, means a possible future event or condition arising from presently known or unknown causes, the outcome of which is indeterminable at the present time.

(b) Costs for contingencies are generally unallowable for historical costing purposes because such costing deals with costs incurred and recorded on the contractor's books. However, in some cases, as for example, terminations, a contingency factor may be recognized when it is applicable to a past period to give recognition to minor unsettled factors in the interest of expediting settlement.

(c) In connection with estimates of future costs, contingencies fall into two categories:

(1) Those that may arise from presently known and existing conditions, the effects of which are foreseeable within reasonable limits of accuracy; e.g., anticipated costs of rejects and defective work. Contingencies of this category are to be included in the estimates of future costs so as to provide the best estimate of performance cost.

(2) Those that may arise from presently known or unknown conditions, the effect of which cannot be measured so precisely as to provide equitable results to the contractor and to the Government; e.g., results of pending litigation. Contingencies of this category are to be excluded from cost estimates under the several items of cost, but should be disclosed separately (including the basis upon which the contingency is computed) to facilitate the negotiation of appropriate contractual coverage. (See, for example, 31.205-6(g), 31.205-19, and 31.205-24.)

31.205-8 Contributions and donations.

Contributions and donations are unallowable.

31.205-9 Reserved.

31.205-10 Cost of money.

(a) *Facilities capital cost of money.*

(1) *General* (i) Facilities capital cost of money (cost of capital committed to facilities) is an imputed cost determined by applying a cost-of-money rate to facilities capital employed in contract performance. A cost-of-money rate is uniformly imputed to all contractors (see subdivision (ii) below). Capital employed is determined without regard to whether its source is equity or borrowed capital. The resulting cost of money is not a form of interest on borrowings (see 31.205-20).

(ii) CAS 414, Cost of Money as an Element of the Cost of Facilities Capital, establishes criteria for measuring and allocating, as an element of contract cost, the cost of capital committed to facilities. Cost-of-money factors are developed on Form CASB-CMF, broken down by overhead pool at the business unit, using (A) business-unit facilities capital data, (B) overhead allocation base data, and (C) the cost-of-money rate, which is based on interest rates specified by the Secretary of the Treasury under 50 U.S.C. App. 1215(b)(2).

(2) *Allowability.* Whether or not the contract is otherwise subject to CAS, facilities capital cost of money is allowable if—

(i) The contractor's capital investment is measured, allocated to contracts, and costed in accordance with CAS 414;

(ii) The contractor maintains adequate records to demonstrate compliance with this standard; and

(iii) The estimated facilities capital cost of money is specifically identified or proposed in cost proposals relating to the contract under which this cost is to be claimed.

(3) *Accounting.* The facilities capital cost of money need not be entered on the contractor's books of account. However, the contractor shall (i) make a memorandum entry of the cost and (ii) maintain, in a manner that permits audit and verification, all relevant schedules, cost data, and other data necessary to support the entry fully.

(4) *Payment.* Facilities capital cost of money that is (i) allowable under subparagraph (2) above and (ii) calculated, allocated, and documented in accordance with this cost principle shall be an "incurred cost" for reimbursement purposes under applicable cost-reimbursement contracts and for progress payment purposes under fixed-price contracts.

(b) *Cost of money as an element of the cost of capital assets under construction.*

(1) *General* (i) Cost of money as an element of the cost of capital assets under construction is an imputed cost determined by applying a cost-of-money rate to the investment in tangible and intangible capital assets while they are being constructed, fabricated, or developed for a contractor's own use. Capital employed is determined without regard to whether its source is equity or borrowed capital. The resulting cost of money is not a form of interest on borrowing (see 31.205-20).

(ii) CAS 417, Cost of Money as an Element of the Cost of Capital Assets Under Construction, establishes criteria for measuring and allocating, as an element of contract cost, the cost of capital

committed to capital assets under construction, fabrication, or development.

(2) *Allowability* (i) Whether or not the contact is otherwise subject to CAS, and except as specified in subdivision (ii) below, the cost of money for capital assets under construction, fabrication, or development is allowable if—

(A) The cost of money is calculated, allocated to contracts, and costed in accordance with CAS 417;

(B) The contractor maintains adequate records to demonstrate compliance with this standard; and

(C) The cost of money for tangible capital assets if included in the capitalized cost that provides the basis for allowable depreciation costs, or, in the case of intangible capital assets, the cost of money is included in the cost of those assets for which amortization costs are allowable.

(ii) Actual interest cost in lieu of the calculated imputed cost of money for capital assets under construction, fabrication, or development is unallowable.

(3) *Accounting.* The cost of money for capital assets under construction need not be entered on the contractor's books of account. However, the contractor shall (i) make a memorandum entry of the cost and (ii) maintain, in a manner that permits audit and verification, all relevant schedules, cost data, and other data necessary to support the entry fully.

(4) *Payment.* The cost of money for capital assets under construction that is allowable under subparagraph (2) above of this cost principle shall be an "incurred cost" for reimbursement purposes under applicable cost-reimbursement contracts and for progress payment purposes under fixed-price contracts.

31.205-11 Depreciation.

(a) Depreciation is a charge to current operations which distributes the cost of a tangible capital asset, less estimated residual value, over the estimated useful life of the asset in a systematic and logical manner. It does not involve a process of valuation. Useful life refers to the prospective period of economic usefulness in a particular contractor's operations as distinguished from physical life; it is evidenced by the actual or estimated retirement and replacement practice of the contractor.

(b) Contractors having contracts subject to CAS 409, Depreciation of Tangible Capital Assets, must adhere to the requirement of that standard for all fully CAS-covered contracts and may elect to adopt the standard for all other contracts. All requirements of CAS 409 are applicable if the election is made, and its requirements supersede any conflicting requirements of this cost principle. Once electing to adopt CAS 409 for all contracts, contractors must continue to follow it until notification of final acceptance of all deliverable items on all open negotiated Government contracts. Paragraphs (c) through (e) below apply to contracts to which CAS 409 is not applied.

(c) Normal depreciation on a contractor's plant, equipment, and other capital facilities is an allowable contract cost, if the contractor is able to demonstrate that it is reasonable and allocable (but see paragrpah (i) below).

(d) Depreciation shall be considered reasonable if the contractor follows policies and procedures that are—

(1) Consistent with those followed in the same cost center for business other than Government;

(2) Reflected in the contractor's books of accounts and financial statements; and

(3) Both used and acceptable for Federal income tax purposes.

(e) When the depreciation reflected on a contractor's books of accounts and financial statements differs from that used and acceptable for Federal income tax purposes, reimbursement shall be based on the asset cost amortized over the estimated useful life of the property using depreciation methods (straight line, sum of the years' digits, etc.) acceptable for income tax purposes. Allowable depreciation shall not exceed the amounts used for book and statement purposes and shall be determined in a manner consistent with the depreciation policies and procedures followed in the same cost center on non-Government business.

(f) Depreciation for reimbursement purposes in the case of tax-exempt organizations shall be determined on the basis described in paragraph (e) immediately above.

(g) Special considerations are required for assets acquired before the effective date of this cost principle if, on that date, the undepreciated balance of these assets resulting from depreciation policies and procedures used previously for Government contracts and subcontracts is different from the undepreciated balance on the books and financial statements. The undepreciated balance for contract cost purposes shall be depreciated over the remaining life using the methods and lives followed for book purposes. The aggregate depreciation of any asset allowable after the effective date of this 31.205-11 shall not exceed the cost basis of the asset less any depreciation allowed or allowable under prior acquisition regulations.

(h) Depreciation should usually be allocated to the contract and other work as an indirect cost. The amount of depreciation allowed in any accounting period may, consistent with the basic objectives in paragraph (a) above, vary with volume of production or use of multishift operations.

(i) In the case of emergency facilities covered by certificates of necessity, a contractor may elect to use normal depreciation without requesting a determination of "true depreciation," or may elect to use either

normal or "true depreciation" after a determination of "true depreciation" has been made by an Emergency Facilities Depreciation Board (EFDB). The method elected must be followed consistently thoughout the life of the emergency facility. When an election is made to use normal depreciation, the criteria in paragraphs (c), (d), (e), and (f) above shall apply for both the emergency period and the post-emergency period. When an election is made to use "true depreciation", the amount allowable as depreciation—

(1) With respect to the emergency period (five years), shall be computed in accordance with the determination of the EFDB and allocated rateably over the full five year emergency period; *provided* no other allowance is made which would duplicate the factors, such as extraordinary obsolescence, covered by the Board's determination; and

(2) After the end of the emergency period, shall be computed by distributing the remaining undepreciated portion of the cost of the emergency facility over the balance of its useful life provided the remaining undepreciated portion of such cost shall not include any amount of unrecovered "true depreciation."

(j) No depreciation, rental, or use charge shall be allowed on property acquired at no cost from the Government by the contractor or by any division, subsidiary, or affiliate of the contractor under common control.

(k) The depreciation on any item which meets the criteria for allowance at a "price" under 31.205-26(e) may be based on that price, provided the same policies and procedures are used for costing all business of the using division, subsidiary, or organization under common control.

(l) No depreciation or rental shall be allowed on property fully depreciated by the contractor or by any division, subsidiary, or affiliate of the contractor under common control. However, a reasonable charge for using fully depreciated property may be agreed upon and allowed (but see 31.109(h)(2)). In determining the charge, consideration shall be given to cost, total estimated useful life at the time of negotiations, effect of any increased maintenance charges or decreased efficiency due to age, and the amount of depreciation previously charged to Government contracts or subcontracts.

(m) CAS 404, Capitalization of Tangible Assets, applies to assets acquired by a "capital lease" as defined in Statement of Financial Accounting Standard No. 13 (FAS-13), Accounting for Leases, issued by the Financial Accounting Standards Board (FASB). Compliance with CAS 404 and FAS-13 requires that such leased assets (capital leases) be treated as purchased assets; i.e., be capitalized and the capitalized value of such assets be distributed over their useful lives as depreciation charges, or over the leased life as amortization charges as appropriate. Assets whose leases are classified as capital leases under FAS-13 are subject to the requirements of 31.205-11 while assets acquired under leases classified as operating leases are subject to the requirements on rental costs in 31.205-36. The standards of financial accounting and reporting prescribed by FAS-13 are incorporated into this principle and shall govern its application, except as provided in subparagraphs (1), (2), and (3) below.

(1) Rental costs under a sale and leaseback arrangement shall be allowable up to the amount that would have been allowed had the contractor retained title to the property.

(2) Capital leases, as defined in FAS-13, for all real and personal property, between any related parties are subject to the requirements of this subparagraph 31.205-11(m). If it is determined that the terms of the lease have been significantly affected by the fact that the lessee and lessor are related, depreciation charges shall not be allowed in excess of those which would have occurred if the lease contained terms consistent with those found in a lease between unrelated parties.

(3) Assets acquired under leases that the contractor must capitalize under FAS-13 shall not be treated as purchased assets for contract purposes if the leases are covered by 31.205-36(b)(4).

31.205-12 Economic planning costs.

(a) This category includes costs of generalized long-range management planning that is concerned with the future overall development of the contractor's business and that may take into account the eventual possibility of economic dislocations or fundamental alterations in those markets in which the contractor currently does business. Economic planning costs do not include organization or reorganization costs covered by 31.205-27.

(b) Economic planning costs are allowable as indirect costs to be properly allocated.

(c) Research and development and engineering costs designed to lead to new products for sale to the general public are not allowable under this principle.

31.205-13 Employee morale, health, welfare, food service, and dormitory costs and credits.

(a) Aggregate costs incurred on activities designed to improve working conditions, employer-employee relations, employee morale, and employee performance (less income generated by these activities) are allowable, except as limited by paragraph (b) immediately below, and to the extent that the net amount is reasonable. Some examples are house publications, health clinics, recreation, employee counseling services, and food and dormitory services, which include operating or furnishing facilities for cafeterias, dining rooms, canteens, lunch wagons, vending machines, living accommodations, or similar types of services for the contractor's employees at or near the contractor's facilities.

(b) Losses from operating food and dormitory services may be included as costs only if the contractor's objective is to operate such services on a break-even

basis. Losses sustained because food services or lodging accommodations are furnished without charge or at prices or rates which would not accomplish the above objective are not allowable. A loss may be allowed, however, to the extent the contractor can demonstrate that unusual circumstances exist (e.g., (i) where the contractor must provide food or dormitory services at remote locations where adequate commercial facilities are not reasonably available or (ii) where it is necessary to operate a facility at a lower volume than the facility could economically support) such that, even with efficient management, operating the services on a break-even basis would require charging inordinately high prices or prices or rates higher than those charged by commercial establishments offering the same services in the same geographical areas. Cost of food and dormitory services shall include an allocable share of indirect expenses pertaining to these activities.

(c) When the contractor has an arrangement authorizing an employee association to provide or operate a service, such as vending machines in the contractor's plant, and retain the profits, such profits shall be treated in the same manner as if the contractor were providing the service (but see paragraph (d) immediately below).

(d) Contributions by the contractor to an employee organization, including funds from vending machine receipts or similar sources, may be included as costs incurrred under paragraph (a) above only to the extent that the contractor demonstrates that an equivalent amount of the costs incurred by the employee organization would be allowable if directly incurred by the contractor.

31.205-14 Entertainment costs.

Costs of amusement, diversion, social activities, and any directly associated costs such as tickets to shows or sports events, meals, lodging, rentals, transportation, and gratuities are unallowable (but see 31.205-13 and 31.205-43).

31.205-15 Fines and penalties.

Costs of fines and penalties resulting from violations of, or failure of the contractor to comply with, Federal, State, or local laws and regulations are unallowable except when incurred as a result of compliance with specific terms and conditions of the contract or written instructions from the contracting officer.

31.205-16 Gains and losses on disposition of depreciable property or other capital assets.

(a) Gains and losses from the sale, retirement, or other disposition (but see 31.205-19) of depreciable property shall be included in the year in which they occur as credits or charges to the cost grouping(s) in which the depreciation or amortization applicable to those assets was included (but see paragraph (d) below).

(b) Gains and losses on disposition of tangible capital assets, incuding those acquired under capital leases (see 31.205-11(m), shall be considered as adjustments of depreciation costs previously recognized. The gain or loss for each asset disposed of is the difference between the net amount realized, including insurance proceeds from involuntary conversions, and its undepreciated balance. The gain recognized for contract costing purposes shall be limited to the difference between the acquisition cost (or for assets acquired under a capital lease, the value at which the leased asset is capitalized) of the asset and its undepreciated balance (except see subdivisions (c)(2)(i) or (ii) below).

(c) Special considerations apply to an involuntary conversion which occurs when a contractor's property is destroyed by events over which the owner has no control, such as fire, windstorm, flood, accident, theft, etc., and an insurance award is recovered. The following govern involuntary conversions:

(1) When there is a cash award and the converted asset is not replaced, gain or loss shall be recognized in the period of disposition. The gain recognized for contract costing purposes shall be limited to the difference between the acquisition cost of the asset and its undepreciated balance.

(2) When the converted asset is replaced, the contractor shall either—

(i) Adjust the depreciable basis of the new asset by the amount of the total realized gain or loss; or

(ii) Recognize the gain or loss in the period of disposition, in which case the Government shall participate to the same extent as outlined in subparagraph (c)(1) above.

(d) Gains and losses on the disposition of depreciable property shall not be recognized as a separate charge or credit when—

(1) Gains and losses are processed through the depreciation reserve account and reflected in the depreciation allowable under 31.205-11; or

(2) The property is exchanged as part of the purchase price of a similar item, and the gain or loss is taken into consideration in the depreciation cost basis of the new item.

(e) Gains and losses arising from mass or extraordinary sales, retirements, or other disposition shall be considered on a case-by-case basis.

(f) Gains and losses of any nature arising from the sale or exchange of capital assets other than depreciable property shall be excluded in computing contract costs.

31.205-17 Idle facilities and idle capacity costs.

(a) "Costs of idle facilities or idle capacity," as used in this subsection, means costs such as maintenance, repair, housing, rent, and other related costs; e.g., property taxes, insurance, and depreciation.

"Facilities," as used in this subsection, means plant or any portion thereof (including land integral to the operation), equipment, individually or collectively, or any

other tangible capital asset, wherever located, and whether owned or leased by the contractor.

"Idle capacity," as used in this subsection, means the unused capacity of partially used facilities. It is the difference between that which a facility could achieve under 100 percent operating time on a one-shift basis, less operating interruptions resulting from time lost for repairs, setups, unsatisfactory materials, and other normal delays, and the extent to which the facility was actually used to meet demands during the accounting period. A multiple-shift basis may be used in the calculation instead of a one-shift basis if it can be shown that this amount of usage could normally be expected for the type of facility involved.

"Idle facilities," as used in this subsection, means completely unused facilities that are excess to the contractor's current needs.

(b) The costs of idle facilities are unallowable unless the facilities—

(1) Are necessary to meet fluctuations in workload; or

, (2) Were necessary when acquired and are now idle because of changes in requirements, production economies, reorganization, termination, or other causes which could not have been reasonably foreseen. (Costs of idle facilities are allowable for a reasonable period, ordinarily not to exceed 1 year, depending upon the initiative taken to use, lease, or dispose of the idle facilities (but see 31.205-42)).

(c) Costs of idle capacity are costs of doing business and are a factor in the normal fluctuations of usage or overhead rates from period to period. Such costs are allowable provided the capacity is necessary or was originally reasonable and is not subject to reduction or elimination by subletting, renting, or sale, in accordance with sound business, economics, or security practices. Widespread idle capacity throughout an entire plant or among a group of assets having substantially the same function may be idle facilities.

(d) Any costs to be paid directly by the Government for idle facilities or idle capacity reserved for defense mobilization production shall be the subject of a separate agreement.

31.205-18 Independent research and development and bid and proposal costs.

(a) *Definitions.*

"Applied research," as used in this subsection, means that effort which (1) normally follows basic research, but may not be severable from the related basic research, (2) attempts to determine and exploit the potential of scientific discoveries or improvements in technology, materials, processes, methods, devices, or techniques, and (3) attempts to advance the state of the art. Applied research does not include efforts whose principal aim is design, development, or test of specific items or services to be considered for sale; these efforts are within the definition of the term "development," defined below.

"Basic research," as used in this subsection, means that research which is directed toward increase of knowledge in science. The primary aim of basic research is a fuller knowledge or understanding of the subject under study, rather than any practical application thereof.

"Bid and proposal (B&P) costs," as used in this subdivision, means the costs incurred in preparing, submitting, and supporting bids and proposals (whether or not solicited) on potential Government or non-Government contracts. The term does not include the costs of effort sponsored by a grant or cooperative agreement or required in contract performance.

"Company," as used in this subsection, means all divisions, subsidiaries, and affiliates of the contractor under common control.

"Development," as used in this subsection, means the systematic use, under whatever name, of scientific and technical knowledge in the design, development, test, or evaluation of a potential new product or service (or of an improvement in an existing product or service) for the purpose of meeting specific performance requirements or objectives. Development includes the functions of design engineering, prototyping, and engineering testing. Development excludes: (1) subcontracted technical effort which is for the sole purpose of developing an additional source for an existing product, or (2) development effort for manufacturing or production materials, systems, processes, methods, equipment, tools, and techniques not intended for sale.

"Independent research and development (IR&D)" means a contractor's IR&D cost that is not sponsored by, or required in performance of, a contract or grant and that consists of projects falling within the four following areas: (1) basic research, (2) applied research, (3) development, and (4) systems and other concept formulation studies. IR&D effort shall not include technical effort expended in developing and preparing technical data specifically to support submitting a bid or proposal.

"Systems and other concept formulation studies," as used in this subsection, means analyses and study efforts either related to specific IR&D efforts or directed toward identifying desirable new systems, equipments or components, or modifications and improvements to existing systems, equipments, or components.

(b) *Composition and allocation of costs.* The requirements of CAS 420, Accounting for Independent Research and Development Costs and Bid and Proposal Costs, are incorporated in their entirety and shall apply as follows—

(1) *Fully-CAS-covered contracts.* Contracts that are fully-CAS-covered shall be subject to all requirements of CAS 420.

(2) *Modified-CAS-covered and non-CAS-covered contracts.* Contracts that are not CAS-covered or that contain terms or conditions requiring modified CAS coverage shall be subject to all requirements of CAS 420 *except* 4 CFR 420.50(e)(2) and 4 CFR 420.50(f)(2), which are not then applicable. However, non-CAS covered or modified CAS-covered contracts awarded at a time the contractor has CAS-covered contracts requiring compliance with CAS 420, shall be subject to all the requirements of CAS 420. When the requirements of 4 CFR 420.50(e)(2) and 4 CFR 420.50(f)(2) are not applicable, the following apply:

(i) IR&D and B&P costs shall be allocated to final cost objectives on the same basis of allocation used for the G&A expense grouping of the profit center (see 31.001) in which the costs are incurred. However, when IR&D and B&P costs clearly benefit other profit centers or benefit the entire company, those costs shall be allocated through the G&A of the other profit centers or through the corporate G&A, as appropriate.

(ii) If allocations of IR&D or B&P through the G&A base do not provide equitable cost allocation, the contracting officer may approve use of a different base.

(c) *Allowability.* Except as provided in paragraph (d) below, costs for IR&D and B&P are allowable only in accordance with the following:

(1) *Companies required to negotiate advance agreements.*

(i) Any company that received payments for IR&D and B&P costs in a fiscal year, either as a prime contractor or subcontractor, exceeding $4 million from Government agencies, is required to negotiate with the Government an advance agreement which establishes a ceiling for allowability of IR&D and B&P costs for the following fiscal year. This agreement is binding on all Government agencies, unless prohibited by statute. The requirements of Section 203 of Pub. L. 91-441 necessitate that the Department of Defense (DOD) be the lead negotiating agency when the contractor has received more than $4 million in payments for IR&D and B&P from DOD. Computation of IR&D and B&P costs to determine whether the threshold criterion was reached shall include only recoverable IR&D and B&P costs allocated during the company's previous fiscal year to prime contracts and subcontracts for which the submission and certification of cost or pricing data were required. (Also see paragraph (b) above and 15.804.) The computation shall include full burdening pursuant to CAS 420.

(ii) When a company meets the criterion in (i) above, required advance agreements may be negotiated at the corporate level and/or with those profit centers that contract directly with the Government and that in the preceding year allocated recoverable IR&D and B&P costs exceeding $500,000, including burdening, to contracts and subcontracts for which the submission and certification of cost or pricing data were required (also see paragraph (b) above and 15.804). When ceilings are negotiated for separate profit centers of the company, the allowability of IR&D and B&P costs for any center that in its previous fiscal year did not reach the $500,000 threshold may be determined in accordance with subparagraph (c)(2) below.

(iii) Ceilings are the maximum dollar amounts of total IR&D and B&P costs that will be allowable for allocation over the appropriate base for that part of the company's operation covered by an advance agreement.

(iv) No IR&D and B&P cost shall be allowable if a company fails to initiate negotiation of a required advance agreement before the end of the fiscal year for which the agreement is required.

(v) When negotiations are held with a company meeting the $4 million criterion or with separate profit centers (when negotiations are held at that level under (ii) above), and if no advance agreement is reached, payment for IR&D and B&P costs shall be reduced below that which the company or profit center would have otherwise received. The amount of such reduced payment shall not exceed 75 percent of the amount which, in the opinion of the contracting officer, the company or profit center would be entitled to receive under an advance agreement. Written notification of the contracting officer's determination of a reduced amount shall be provided the contractor. In the event that an advance agreement is not reached before the end of the contractor's fiscal year for which the agreement is to apply, negotiations shall immediately be terminated, and the contracting officer shall furnish a determination of the reduced amount.

(vi) Contractors may appeal decisions of the contracting officer to reduce payment. The appeal shall be filed with the contracting officer within 30 days of receipt of the contracting officer's determination. (Also see Subpart 42.10.)

(2) *Companies not required to negotiate advance agreements.* Ceilings for allowable IR&D and B&P costs for companies not required to negotiate advance agreements in accordance with subparagraph (c)(1) above shall be established by a formula, either on a company-wide basis or by profit centers, computed as follows:

(i) Determine the ratio of IR&D/B&P costs to total sales (or other base acceptable to the contracting officer) for each of the preceding three

years and average the two highest of these ratios; this average is the IR&D/B&P historical ratio;

(ii) Compute the average annual IR&D/B&P costs (hereafter called average), using the two highest of the preceding three years;

(iii) IR&D/B&P costs for the center for the current year which are not in excess of the product of the center's actual total sales (or other accepted base) for the current year and the IR&D/B&P historical ratio computed under (i) above (hereafter called product) shall be considered allowable only to the extent the product does not exceed 120 percent of the average. If the product is less than 80 percent of the average, costs up to 80 percent of the average shall be allowable.

(iv) However, at the discretion of the contracting officer, an advance agreement may be negotiated when the contractor can demonstrate that the formula would produce a clearly inequitable cost recovery.

(d) *Deferred IR&D and B&P costs.* (1) IR&D costs that were incurred in previous accounting periods are unallowable, except when a contractor has developed a specific product at its own risk in anticipation of recovering the development costs in the sale price of the product provided that—

(i) The total amount of IR&D costs applicable to the product can be identified;

(ii) The proration of such costs to sales of the product is reasonable;

(iii) The contractor had no Government business during the time that the costs were incurred or did not allocate IR&D costs to Government contracts except to prorate the cost of developing a specific product to the sales of that product; and

(iv) No costs of current IR&D programs are allocated to Government work except to prorate the costs of developing a specific product to the sales of that product.

(2) When deferred costs are recognized, the contract (except firm-fixed-price and fixed-price with economic price adjustment) will include a specific provision setting forth the amount of deferred IR&D costs that are allocable to the contract. The negotiation memorandum will state the circumstances pertaining to the case and the reason for accepting the deferred costs.

31.205-19 Insurance and indemnification.

(a) Insurance by purchase or by self-insuring includes coverage the contractor is required to carry, or to have approved, under the terms of the contract and any other coverage the contractor maintains in connection with the general conduct of its business. Any contractor desiring to establish a program of self-insurance applicable to contracts that are not subject to CAS 416, Accounting for Insurance Costs, shall comply with the self-insurance requirements of that standard as well as with Part 28 of this Regulation. However, approval of a contractor's insurance program in accordance with Part 28 does not constitute a determination as to the allowability of the program's cost. The amount of insurance costs which may be allowed is subject to the cost limitations and exclusions in the following subparagraphs.

(1) Costs of insurance required or approved, and maintained by the contractor pursuant to the contract, are allowable.

(2) Costs of insurance maintained by the contractor in connection with the general conduct of its business are allowable, subject to the following limitations:

(i) Types and extent of coverage shall follow sound business practice, and the rates and premiums must be reasonable.

(ii) Costs allowed for business interruption or other similar insurance must be limited to exclude coverage of profit.

(iii) The cost of property insurance premiums for insurance coverage in excess of the acquisition cost of the insured assets is allowable only when the contractor has a formal written policy assuring that in the event the insured property is involuntarily converted, the new asset shall be valued at the book value of the replaced asset plus or minus adjustments for differences between insurance proceeds and actual replacement cost. If the contractor does not have such a formal written policy, the cost of premiums for insurance coverage in excess of the acquisition cost of the insured asset is unallowable.

(iv) Costs of insurance for the risk of loss of or damage to Government property are allowable only to the extent that the contractor is liable for such loss or damage and such insurance does not cover loss or damage that results from willful misconduct or lack of good faith on the part of any of the contractor's directors or officers or other equivalent representatives.

(v) Contractors operating under a program of self-insurance must obtain approval of the program when required by 28.308(a).

(vi) Costs of insurance on the lives of officers, partners, or proprietors are allowable only to the extent that the insurance represents additional compensation (see 31.205-6).

(3) Actual losses are unallowable unless expressly provided for in the contract, except—

(i) Losses incurred under the nominal deductible provisions of purchased insurance, in keeping with sound business practice, are allowable for contracts not subject to CAS 416 and when the contractor did not establish a self-insurance program. Such contracts are not subject to the self-insurance requirements of CAS 416. For contracts subject to CAS 416, and for those made subject to the self-

insurance requirements of that Standard as a result of the contractor's having established a self-insurance program (see paragraph (a) above), actual losses may be used as a basis for charges under a self-insurance program when the actual amount of losses will not differ significantly from the projected average losses for the accounting period (see 4 CFR 416.50(a)(2)(ii)).

(ii) Minor losses, such as spoilage, breakage, and disappearance of small hand tools that occur in the ordinary course of doing business and that are not covered by insurance are allowable.

(4) The cost of insurance to protect the contractor against the costs of correcting its own defects in materials or workmanship is unallowable. However, insurance costs to cover fortuitous or casualty losses resulting from defects in materials or workmanship are allowable as a normal business expense.

(b) If purchased insurance is available, the charge for any self-insurance coverage plus insurance administration expenses shall not exceed the cost of comparable purchased insurance plus associated insurance administration expenses.

(c) Insurance provided by captive insurers (insurers owned by or under the control of the contractor) is considered self-insurance, and charges for it must comply with the self-insurance provisions of CAS 416. However, if the captive insurer also sells insurance to the general public in substantial quantities and it can be demonstrated that the charge to the contractor is based on competitive market forces, the insurance will be considered purchased insurance.

(d) The allowability of premiums for insurance purchased from fronting insurance companies (insurance companies not related to the contractor but who reinsure with a captive insurer of the contractor) shall not exceed the amount (plus reasonable fronting company charges for services rendered) which the contractor would have been allowed had it insured directly with the captive insurer.

(e) Self-insurance charges for risks of catastrophic losses are not allowable (see 28.308(e)).

(f) The Government is obligated to indemnify the contractor only to the extent authorized by law, as expressly provided for in the contract, except as provided in paragraph (d) above.

(g) Late premium payment charges related to employee deferred compensation plan insurance incurred pursuant to Section 4007 (29 U.S.C. 1307) or Section 4023 (29 U.S.C. 1323) of the Employee Retirement Income Security Act of 1974 are unallowable.

31.205-20 Interest and other financial costs.

Interest on borrowings (however represented), bond discounts, costs of financing and refinancing capital (net worth plus long-term liabilities), legal and professional fees paid in connection with preparing prospectuses, costs of preparing and issuing stock rights, and directly associated costs are unallowable except for interest assessed by State or local taxing authorities under the conditions specified in 31.205-41 (but see 31.205-28).

31.205-21 Labor relations costs.

Costs incurred in maintaining satisfactory relations between the contractor and its employees, including costs of shop stewards, labor management committees, employee publications, and other related activities, are allowable.

31.205-22 Lobbying costs.

(a) Lobbying is defined as any activity or communication that is intended or designed (1) to directly influence members of the U.S. Congress or State and local legislatures, their staffs, or the staffs of committees of these bodies to favor or oppose pending, proposed, or existing legislation, appropriations, or other official actions of these bodies, their members, or their committees, or (2) to engage in any campaign to directly encourage others to do so. Except as provided in paragraph (c) below, lobbying includes, but is not limited to, appearances before any legislative committee or subcommittee and written or oral communications, including face-to-face discussions or conferences, telephone conversations, paid advertisements, and the sending of telegrams or letters.

(b) The costs of lobbying, including the applicable portion of the salaries and fees of those individuals engaged in lobbying efforts on behalf of a contractor, whether or not the individuals are registered as lobbyists under any applicable law, are unallowable.

(c) Legislative liaison activities, such as attendance at committee hearings and gathering information regarding pending legislation, are not lobbying and are allowable. In addition, written or oral communications, appearances before legislative committees and subcommittees, and meetings with legislative representatives are allowable legislative liaison activities when such efforts are undertaken in conjunction with a legislative public hearing or meeting in response to a public notice, or a specific invitation or request from a legislative source, and the notice, invitation, or request is documented. However, for the costs to be allowable, the contractor shall maintain and make available to the Government records and documentation sufficient to identify the costs and clearly establish the nature and purpose of the legislative liaison activity to which the costs relate.

31.205-23 Losses on other contracts.

An excess of costs over income under any other contract (including the contractor's contributed portion under cost-sharing contracts) is unallowable.

31.205-24 Maintenance and repair costs.

(a) Costs necessary for the upkeep of property (including Government property, unless otherwise provided for) that neither add to the permanent value of the property nor appreciably prolong its intended life,

but keep it in an efficient operating condition, are to be treated as follows (but see 31.205-11):

(1) Normal maintenance and repair costs are allowable.

(2) Extraordinary maintenance and repair costs are allowable, provided those costs are allocated to the applicable periods for purposes of determining contract costs (but see 31.109).

(b) Expenditures for plant and equipment, including rehabilitation which should be capitalized and subject to depreciation, according to generally accepted accounting principles as applied under the contractor's established policy or, when applicable, according to CAS 404, Capitalization of Tangible Assets, are allowable only on a depreciation basis.

31.205-25 Manufacturing and production engineering costs.

(a) The costs of manufacturing and production engineering effort as described in (1) through (4) below are all allowable:

(1) Developing and deploying new or improved materials, systems, processes, methods, equipment, tools and techniques that are or are expected to be used in producing products or services;

(2) Developing and deploying pilot production lines;

(3) Improving current production functions, such as plant layout, production scheduling and control, methods and job analysis, equipment capabilities and capacities, inspection techniques, and tooling analysis (including tooling design and application improvements); and

(4) Material and manufacturing producibility analysis for production suitability and to optimize manufacturing processes, methods, and techniques.

(b) This cost principle does not cover:

(1) Basic and applied research effort (as defined in 31.205-18(a)) related to new technology, materials, systems, processes, methods, equipment, tools and techniques. Such technical effort is governed by 31.205-18, Independent research and development costs; and

(2) Development effort for manufacturing or production materials, systems, processes, methods, equipment, tools and techniques that are intended for sale is also governed by 31.205-18.

(c) Where manufacturing or production development costs are capitalized or required to be capitalized under the contractor's capitalization policies, allowable cost will be determined in accordance with the requirements of 31.205-11, Depreciation.

31.205-26 Material costs.

(a) Material costs include the costs of such items as raw materials, parts, sub-assemblies, components, and manufacturing supplies, whether purchased or manufactured by the contractor, and may include such collateral items as inbound transportation and intransit insurance. In computing material costs, consideration shall be given to reasonable overruns, spoilage, or defective work (unless otherwise provided in any contract provision relating to inspecting and correcting defective work). These costs are allowable, subject to the requirements of paragraphs (b) through (e) below.

(b) Costs of material shall be adjusted for income and other credits, including available trade discounts, refunds, rebates, allowances, and cash discounts, and credits for scrap, salvage, and material returned to vendors. Such income and other credits shall either be credited directly to the cost of the material or be allocated as a credit to indirect costs. When the contractor can demonstrate that failure to take cash discounts was reasonable, lost discounts need not be credited.

(c) Reasonable adjustments arising from differences between periodic physical inventories and book inventories may be included in arriving at costs; *provided*, such adjustments relate to the period of contract performance.

(d) When materials are purchased specifically for and are identifiable solely with performance under a contract, the actual purchase cost of those materials should be charged to the contract. If material is issued from stores, any generally recognized method of pricing such material is acceptable if that method is consistently applied and the results are equitable. When estimates of future material costs are required, current market price or anticipated acquisition cost may be used, but the basis of pricing must be disclosed.

(e) Allowance for all materials, supplies, and services that are sold or transferred between any divisions, subsidiaries, or affiliates of the contractor under a common control shall be on the basis of cost incurred in accordance with this subpart. However, allowance may be at a price when it is the established practice of the transferring organization to price interorganizational transfers at other than cost for commercial work of the contractor or any division, subsidiary, or affiliate of the contractor under a common control, and when the price—

(1) Is or is based on an "established catalog or market price of commercial items sold in substantial quantities to the general public" in accordance with 15.804; or

(2) Is the result of "adequate price competition" in accordance with 15.804 and is the price at which an award was made to the affiliated organization after obtaining quotations on an equal basis from such organization and one or more outside sources that produce the item or its equivalent in significant quantity.

(3) Provided, that in either subparagraph (1) or (2) above—

(i) The price is not in excess of the transferor's current sales price to its most favored customer (including any division, subsidiary or affiliate of

the contractor under a common control) for a like quantity under comparable conditions; and

(ii) The contracting officer has not determined the price to be unreasonable.

(f) The price determined in accordance with subparagraph (e)(1) above should be adjusted to reflect the quantities being acquired and may be adjusted to reflect actual cost of any modifications necessary because of contract requirements.

31.205-27 Organization costs.

(a) Except as provided in paragraph (b) below, expenditures in connection with (1) planning or executing the organization or reorganization of the corporate structure of a business, including mergers and acquisitions, or (2) raising capital (net worth plus long-term liabilities), are unallowable. Such expenditures include but are not limited to incorporation fees and costs of attorneys, accountants, brokers, promoters and organizers, management consultants and investment counsellors, whether or not employees of the contractor. Unallowable "reorganization" costs include the cost of any change in the contractor's financial structure, excluding administrative costs of short-term borrowings for working capital, resulting in alterations in the rights and interests of security holders, whether or not additional capital is raised.

(b) The cost of activities primarily intended to provide compensation will not be considered organizational costs subject to this subsection, but will be governed by 31.205-6. These activities include acquiring stock for (1) executive bonuses, (2) employee savings plans, and (3) employee stock ownership plans.

31.205-28 Other business expenses.

The following types of recurring costs are allowable when allocated on an equitable basis:

(a) Registry and transfer charges resulting from changes in ownership of securities issued by the contractor.

(b) Cost of shareholders' meetings.

(c) Normal proxy solicitations.

(d) Preparing and publishing reports to shareholders.

(e) Preparing and submitting required reports and forms to taxing and other regulatory bodies.

(f) Incidental costs of directors' and committee meetings.

(g) Other similar costs.

31.205-29 Plant protection costs.

Costs of items such as (a) wages, uniforms, and equipment of personnel engaged in plant protection, (b) depreciation on plant protection capital assets, and (c) necessary expenses to comply with military requirements, are allowable.

31.205-30 Patent costs.

(a) The following patent costs are allowable to the extent that they are incurred as requirements of a Government contract (but see 31.205-33):

(1) Costs of preparing invention disclosures, reports, and other documents.

(2) Costs for searching the art to the extent necessary to make the invention disclosures.

(3) Other costs in connection with the filing and prosecution of a United States patent application where title or royalty-free license is to be conveyed to the Government.

(b) General counseling services relating to patent matters, such as advice on patent laws, regulations, clauses, and employee agreements, are allowable (but see 31.205-33).

(c) Other than those for general counseling services, patent costs not required by the contract are unallowable. (See also 31.205-37.)

31.205-31 Plant reconversion costs.

Plant reconversion costs are those incurred in restoring or rehabilitating the contractor's facilities to approximately the same condition existing immediately before the start of the Government contract, fair wear and tear excepted. Reconversion costs are unallowable except for the cost of removing Government property and the restoration or rehabilitation costs caused by such removal. However, in special circumstances where equity so dictates, additional costs may be allowed to the extent agreed upon before costs are incurred. Care should be exercised to avoid duplication through allowance as contingencies, additional profit or fee, or in other contracts.

31.205-32 Precontract costs.

Precontract costs are those incurred before the effective date of the contract directly pursuant to the negotiation and in anticipation of the contract award when such incurrence is necessary to comply with the proposed contract delivery schedule. Such costs are allowable to the extent that they would have been allowable if incurred after the date of the contract (see 31.109.)

31.205-33 Professional and consultant service costs.

(a) Costs of professional and consultant services rendered by persons who are members of a particular profession or possess a special skill and who are not officers or employees of the contractor are allowable subject to paragraphs (b), (c), (d), and (e) below when reasonable in relation to the services rendered and when not contingent upon recovery of the costs from the Government (but see 31.205-30).

(b) In determining the allowability of costs (including retainer fees) in a particular case, no single factor or any special combination of factors is necessarily determinative. However, the following factors, among others, should be considered:

(1) The nature and scope of the service rendered in relation to the service required.

(2) The necessity of contracting for the service, considering the contractor's capability in the particular area.

(3) The past pattern of such costs, particularly in the years prior to the award of Government contracts.

(4) The impact of Government contracts on the contractor's business.

(5) Whether the proportion of Government work to the contractor's total business is such as to influence the contractor in favor of incurring the cost, particularly when the services rendered are not of a continuing nature and have little relationship to work under Government contracts.

(6) Whether the service can be performed more economically by employment rather than by contracting.

(7) The qualifications of the individual or concern rendering the service and the customary fee charged, especially on non-government contracts.

(8) Adequacy of the contractual agreement for the service (e.g., description of the service; estimate of time required; rate of compensation; termination provisions).

(c) Retainer fees to be allowable must be supported by evidence that—

(1) The services covered by the retainer agreement are necessary and customary;

(2) The level of past services justifies the amount of the retainer fees (if no services were rendered, fees are not automatically unallowable); and

(3) The retainer fee is reasonable in comparison with maintaining an in-house capability to perform the covered services, when factors such as cost and level of expertise are considered.

(d) Costs of legal, accounting, and consulting services and directly associated costs incurred in connection with organization and reorganization (also see 31.205-27), defense of antitrust suits, or the prosecution of claims against the Government are unallowable. Such costs incurred in connection with patent infringement litigation are unallowable unless otherwise provided for in the contract.

(e) Except for retainers, fees for services rendered shall be allowable only when supported by evidence of the nature and scope of the service furnished. (Also see 31.205-38(c).)

31.205-34 Recruitment costs.

(a) Subject to paragraphs (b) and (c) below, and provided that the size of the staff recruited and maintained is in keeping with workload requirements, the following costs are allowable:

(1) Costs of help-wanted advertising.

(2) Costs of operating an employment office needed to secure and maintain an adequate labor force.

(3) Costs of operating an aptitude and educational testing program.

(4) Travel costs of employees engaged in recuiting personnel.

(5) Travel costs of applicants for interviews.

(6) Costs for employment agencies, not in excess of standard commercial rates.

(b) Help-wanted advertising costs are unallowable if the advertising—

(1) Is for personnel other than those required to perform obligations under a Government contract;

(2) Does not describe specific positions or classes of positions;

(3) Is excessive relative to the number and importance of the positions or to the industry practices;

(4) Includes material that is not relevant for recruitment purposes, such as extensive illustrations or descriptions of the company's products or capabilities;

(5) Is designed to "pirate" personnel from another Government contractor; or

(6) Includes color (in publications).

(c) Excessive compensation costs offered to prospective employees to "pirate" them from another Government contractor are unallowable. Such excessive costs may include salaries, fringe benefits, or special emoluments which are in excess of standard industry practices or the contractor's customary compensation practices.

31.205-35 Relocation costs.

(a) Relocation costs are costs incident to the permanent change of duty assignment (for an indefinite period or for a stated period of not less than 12 months) of an existing employee or upon recruitment of a new employee. The following types of costs are allowable as noted, subject to paragraphs (c) and (d) below:

(1) Cost of travel of the employee and members of the immediate family (see 31.205-46) and transportation of the household and personal effects to the new location.

(2) Cost of finding a new home, such as advance trips by employees and spouses to locate living quarters, and temporary lodging during the transition periods not exceeding separate cumulative totals of 60 days for employees and 45 days for spouses and dependents, including advance trip time.

(3) Closing costs (i.e., brokerage fees, legal fees, appraisal fees, points, finance charges, etc.) incident to the disposition of actual residence owned by the employee when notified of transfer, except that these costs when added to the costs described in subparagraph (a)(4) below shall not exceed 14 percent of the sales price of the property sold.

(4) Continuing costs of ownership of the vacant former actual residence being sold, such as maintenance of building and grounds (exclusive of fixing up expenses), utilities, taxes, property insurance, mortgage interest, after settlement date or lease date of new permanent residence, except that these costs when added to the costs described in subparagraph

(a)(3) above, shall not exceed 14 percent of the sales price of the property sold.

(5) Other necessary and reasonable expenses normally incident to relocation, such as disconnecting and connecting household appliances; automobile registration; driver's license and use taxes; cutting and fitting rugs, draperies, and curtains; forfeited utility fees and deposits; and purchase of insurance against damage to or loss of personal property while in transit.

(6) Costs incident to acquiring a home in a new location, except that (i) these costs will not be allowable for existing employees or newly recruited employees who, before the relocation, were not homeowners and (ii) the total costs shall not exceed 5 percent of the purchase price of the new home.

(7) Mortgage interest differential payments, except that these costs are not allowable for existing or newly recruited employees who, before the relocation, were not homeowners and the total payments are limited to an amount determined as follows:

(i) The difference between the mortgage interest rates of the old and new residences times the current balance of the old mortgage times 3 years.

(ii) When mortgage differential payments are made on a lump sum basis and the employee leaves or is transferred again in less than 3 years, the amount initially recognized shall be proportionately adjusted to reflect payments only for the actual time of the relocation.

(8) Rental differential payments covering situations where relocated employees retain ownership of a vacated home in the old location and rent at the new location. The rented quarters at the new location must be comparable to those vacated, and the allowable differential payments may not exceed the actual rental costs for the new home, less the fair market rent for the vacated home times 3 years.

(9) Cost of canceling an unexpired lease.

(b) The costs described in paragraph (a) above must also meet the following criteria to be considered allowable:

(1) The move must be for the benefit of the employer.

(2) Reimbursement must be in accordance with an established policy or practice that is consistenly followed by the employer and is designed to motivate employees to relocate promptly and economically.

(3) The costs must not otherwise be unallowable under Subpart 31.2.

(4) Amounts to be reimbursed shall not exceed the employee's actual expenses, except that for miscellaneous costs of the type discussed in subparagraph (a)(5) above, a flat amount, not to exceed $1,000, may be allowed in lieu of actual costs.

(c) The following types of costs are not allowable:

(1) Loss on sale of a home.

(2) Costs incident to acquiring a home in a new location as follows:

(i) Real estate brokers fees and commissions.

(ii) Cost of litigation.

(iii) Real and personal property insurance against damage or loss of property.

(iv) Mortgage life insurance.

(v) Owner's title policy insurance when such insurance was not previously carried by the employee on the old residence (however, cost of a mortgage title policy is allowable).

(vi) Property taxes and operating or maintenance costs.

(3) Continuing mortgage principal payments on residence being sold.

(4) Payments for employee income or FICA (social security) taxes incident to reimbursed relocation costs.

(5) Payments for job counseling and placement assistance to employee spouses and dependents who were not employees of the contractor at the old location.

(6) Costs incident to furnishing equity or nonequity loans to employees or making arrangements with lenders for employees to obtain lower-than-market rate mortgage loans.

(d) If relocation costs for an employee have been allowed either as an allocable indirect or direct cost, and the employee resigns within 12 months for reasons within the employee's control, the contractor shall refund or credit the relocation costs to the Government.

(e) Subject to the requirements of paragraphs (a) through (d) above, the costs of family movements and of personnel movements of a special or mass nature are allowable. The cost, however, should be assigned on the basis of work (contracts) or time period benefited.

31.205-36 Rental costs.

(a) This subsection is applicable to the cost of renting or leasing real or personal property, except ADPE (see 31.205-2), acquired under "operating leases" as defined in Statement of Financial Accounting Standards No. 13 (FAS-13), Accounting for Leases. Compliance with 31.205-11(l) requires that assets acquired by means of capital leases, as defined in FAS-13, shall be treated as purchased assets; i.e., be capitalized and the capitalized value of such assets be distributed over their useful lives as depreciation charges, or over the lease term as amortization charges, as appropriate (but see subparagraph (b)(4) below).

(b) The following costs are allowable:

(1) Rental costs under operating leases, to the extent that the rates are reasonable at the time of the lease decision, after consideration of (i) rental costs of comparable property, if any; (ii) market conditions in the area; (iii) the type, life expectancy, condition,

and value of the property leased; (iv) alternatives available; and (v) other provisions of the agreement.

(2) Rental costs under a sale and leaseback arrangement only up to the amount the contractor would be allowed if the contractor retained title.

(3) Charges in the nature of rent for property between any divisions, subsidiaries, or organization under common control, to the extent that they do not exceed the normal costs of ownership, such as depreciation, taxes, insurance, facilities capital cost of money, and maintenance (excluding interest or other unallowable costs pursuant to Part 31), provided that no part of such costs shall duplicate any other allowed cost. Rental cost of personal property leased from any division, subsidiary, or affiliate of the contractor under common control, that has an established practice of leasing the same or similar property to unaffiliated lessees shall be allowed in accordance with subparagraph (b)(1) above.

(4) Rental costs under leases entered into before March 1, 1970 for the remaining term of the lease (excluding options not exercised before March 1, 1970) to the extent they would have been allowable under Defense Acquisition Regulation (Formerly ASPR) 15-205.34 or Federal Procurement Regulations section 1-15.205-34 in effect 1 January 1969.

(c) The allowability of rental costs under unexpired leases in connection with terminations is treated in 31.205-42(e).

31.205-37 Royalties and other costs for use of patents.

(a) Royalties on a patent or amortization of the cost of purchasing a patent or patent rights necessary for the proper performance of the contract and applicable to contract products or processes are allowable unless—

(1) The Government has a license or the right to a free use of the patent;

(2) The patent has been adjudicated to be invalid, or has been administratively determined to be invalid;

(3) The patent is considered to be unenforceable; or

(4) The patent is expired.

(b) Care should be exercised in determining reasonableness when the royalties may have been arrived at as a result of less-than-arm's-length bargaining; e.g., royalties—

(1) Paid to persons, including corporations, affiliated with the contractor;

(2) Paid to unaffiliated parties, including corporations, under an agreement entered into in contemplation that a Government contract would be awarded; or

(3) Paid under an agreement entered into after the contract award.

(c) In any case involving a patent formerly owned by the contractor, the royalty amount allowed should not exceed the cost which would have been allowed had the contractor retained title.

(d) See 31.109 regarding advance agreements.

31.205-38 Selling costs.

(a) Selling costs arise in the marketing of the contractor's products and include costs of sales promotions, negotiation, liaison between Government representatives and contractor's personnel, and related activities.

(b) Selling costs are allowable to the extent that they are reasonable and are allocable to Government business (but see 31.109 and 31.205-1). Allocability of selling costs shall be determined in the light of reasonable benefit to the Government arising from such activities as technical, consulting, demonstration, and other services which are for purposes such as application or adaptation of the contractor's products to Government use for its own requirements. Selling costs incurred in connection with potential and actual Foreign Military Sales as defined by the Arms Export Control Act, or foreign sales of military products shall not be allocable to U.S. Government contracts for U.S. Government requirements.

(c) Notwithstanding paragraph (b) above, sellers' or agents' compensation, fees, commissions, percentages, retainer, or brokerage fees, whether or not contingent upon the award of contracts, are allowable only when paid to bona fide employees or established commercial or selling agencies maintained by the contractor for the purpose of securing business (see subsection 3.408-2).

31.205-39 Service and warranty costs.

Service and warranty costs include those arising from fulfillment of any contractual obligation of a contractor to provide services such as installation, training, correcting defects in the products, replacing defective parts, and making refunds in the case of inadequate performance. When not inconsistent with the terms of the contract, such service and warranty costs are allowable. However, care should be exercised to avoid duplication of the allowance as an element of both estimated product cost and risk.

31.205-40 Special tooling and special test equipment costs.

(a) The terms "special tooling" and "special test equipment" are defined in 45.101.

(b) The cost of special tooling and special test equipment used in performing one or more Government contracts is allowable and shall be allocated to the specific Government contract or contracts for which acquired, except that the cost of (1) items acquired by the contractor before the effective date of the contract (or replacement of such items), whether or not altered or adapted for use in performing the contract, and (2) items which the contract schedule specifically excludes, shall be allowable only as depreciation or amortization.

(c) When items are disqualified as special tooling or special test equipment because with relatively minor expense they can be made suitable for general purpose use and have a value as such commensurate with their value as special tooling or special test equipment, the cost of adapting the items for use under the contract and the cost of returning them to their prior configuration are allowable.

31.205-41 Taxes.

(a) The following types of costs are allowable:

(1) Federal, State, and local taxes (see Part 29), except as otherwise provided in paragraph (b) below that are required to be and are paid or accrued in accordance with generally accepted accounting principles. Fines and penalties are not considered taxes.

(2) Taxes otherwise allowable under subparagraph (a)(1) above, but upon which a claim of illegality or erroneous assessment exists; provided the contractor, before paying such taxes—

(i) Promptly requests instructions from the contracting officer concerning such taxes; and

(ii) Takes all action directed by the contracting officer arising out of subparagraph (2)(i) above or an independent decision of the Government as to the existence of a claim of illegality or erroneous assessment, to (A) determine the legality of the assessment or (B) secure a refund of such taxes.

(3) Pursuant to subparagraph (a) (2) above, the reasonable costs of any action taken by the contractor at the direction or with the concurrence of the contracting officer. Interest or penalties incurred by the contractor for non-payment of any tax at the direction of the contracting officer or by reason of the failure of the contracting officer to ensure timely direction after a prompt request.

(b) The following types of costs are not allowable:

(1) Federal income and excess profits taxes.

(2) Taxes in connection with financing, refinancing, refunding operations, or reorganizations (see 31.205-20 and 31.205-27).

(3) Taxes from which exemptions are available to the contractor directly, or available to the contractor based on an exemption afforded the Government, except when the contracting officer determines that the administrative burden incident to obtaining the exemption outweighs the corresponding benefits accruing to the Government. When partial exemption from a tax is attributable to Government contract activity, taxes charged to such work in excess of that amount resulting from application of the preferential treatment are unallowable. These provisions intend that tax preference attributable to Government contract activity be realized by the Government. The term "exemption" means freedom from taxation in whole or in part and includes a tax abatement or reduction resulting from mode of assessment, method of calculation, or otherwise.

(4) Special assessments on land that represent capital improvements.

(5) Taxes (including excises) on real or personal property, or on the value, use, possession or sale thereof, which is used solely in connection with work other than on Government contracts (see paragraph (c) below).

(6) Taxes on accumulated funding deficiencies of, or prohibited transactions involving, employee deferred compensation plans pursuant to Section 4971 or Section 4975 of the Internal Revenue Code of 1954, as amended.

(7) Income tax accruals designed to account for the tax effects of differences between taxable income and pretax income as reflected by the books of account and financial statements.

(c) Taxes on property (see subparagraph (b)(5) above) used solely in connection with either non-Government or Government work should be considered directly applicable to the respective category of work unless the amounts involved are insignificant or comparable results would otherwise be obtained; e.g., taxes on contractor-owned work-in-process which is used solely in connection with non-Government work should be allocated to such work; taxes on contractor-owned work-in-process inventory (and Government-owned work-in-process inventory when taxed) used solely in connection with Government work should be charged to such work. The cost of taxes incurred on property used in both Government and non-Government work shall be apportioned to all such work based upon the use of such property on the respective final cost objectives.

(d) Any taxes, interest, or penalties that were allowed as contract costs and are refunded to the contractor shall be credited or paid to the Government in the manner it directs. However, any interest actually paid or credited to a contractor incident to a refund of tax, interest, or penalty shall be paid or credited to the Government only to the extent that such interest accrued over the period during which the contractor had been reimbursed by the Government for the taxes, interest, or penalties.

31.205-42 Termination costs.

Contract terminations generally give rise to the incurrence of costs or the need for special treatment of costs that would not have arisen had the contract not been terminated. The following cost principles peculiar to termination situations are to be used in conjunction with the other cost principles in Subpart 31.2:

(a) *Common items.* The costs of items reasonably usable on the contractor's other work shall not be allowable unless the contractor submits evidence that the items could not be retained at cost without sustaining a loss. The contracting officer should consider the contractor's plans and orders for current and planned production when determining if items can reasonably

be used on other work of the contractor. Contemporaneous purchases of common items by the contractor shall be regarded as evidence that such items are reasonably usable on the contractor's other work. Any acceptance of common items as allocable to the terminated portion of the contract should be limited to the extent that the quantities of such items on hand, in transit, and on order are in excess of the reasonable quantitative requirements of other work.

(b) *Costs continuing after termination.* Despite all reasonable efforts by the contractor, costs which cannot be discontinued immediately after the effective date of termination are generally allowable. However, any costs continuing after the effective date of the termination due to the negligent or willful failure of the contractor to discontinue the costs shall be unallowable.

(c) *Initial costs.* Initial costs (see 15.804-6(f)), including starting load and preparatory costs, are allowable as follows:

(1) Starting load costs not fully absorbed because of termination are nonrecurring labor, material, and related overhead costs incurred in the early part of production and result from factors such as—

(i) Excessive spoilage due to inexperienced labor;

(ii) Idle time and subnormal production due to testing and changing production methods;

(iii) Training; and

(iv) Lack of familiarity or experience with the product, materials, or manufacturing processes.

(2) Preparatory costs incurred in preparing to perform the terminated contract include such costs as those incurred for initial plant rearrangement and alterations, management and personnel organization, and production planning. They do not include special machinery and equipment and starting load costs.

(3) When initial costs are included in the settlement proposal as a direct charge, such costs shall not also be included in overhead. Initial costs attributable to only one contract shall not be allocated to other contracts.

(4) If initial costs are claimed and have not been segregated on the contractor's books, they shall be segregated for settlement purposes from cost reports and schedules reflecting that high unit cost incurred during the early stages of the contract.

(5) If the settlement proposal is on the inventory basis, initial costs should normally be allocated on the basis of total end items called for by the contract immediately before termination; however, if the contract includes end items of a diverse nature, some other equitable basis may be used, such as machine or labor hours.

(d) *Loss of useful value.* Loss of useful value of special tooling, and special machinery and equipment is generally allowable, provided—

(1) The special tooling, or special machinery and equipment is not reasonably capable of use in the other work of the contractor;

(2) The Government's interest is protected by transfer of title or by other means deemed appropriate by the contracting officer; and

(3) The loss of useful value for any one terminated contract is limited to that portion of the acquisition cost which bears the same ratio to the total acquisition cost as the terminated portion of the contract bears to the entire terminated contract and other Government contracts for which the special tooling, or special machinery and equipment was acquired.

(e) *Rental under unexpired leases.* Rental costs under unexpired leases, less the residual value of such leases, are generally allowable when shown to have been reasonably necessary for the performance of the terminated contract, if—

(1) The amount of rental claimed does not exceed the reasonable use value of the property leased for the period of the contract and such further period as may be reasonable; and

(2) The contractor makes all reasonable efforts to terminate, assign, settle, or otherwise reduce the cost of such lease.

(f) *Alterations of leased property.* The cost of alterations and reasonable restorations required by the lease may be allowed when the alterations were necessary for performing the contract.

(g) *Settlement expenses.* (1) Settlement expenses, including the following, are generally allowable:

(i) Accounting, legal, clerical, and similar costs reasonably necessary for—

(A) The preparation and presentation, including supporting data, of settlement claims to the contracting officer; and

(B) The termination and settlement of subcontracts.

(ii) Reasonable costs for the storage, transportation, protection, and disposition of property acquired or produced for the contract.

(iii) Indirect costs related to salary and wages incurred as settlement expenses in (i) and (ii); normally, such indirect costs shall be limited to payroll taxes, fringe benefits, occupancy costs, and immediate supervision costs.

(2) If settlement expenses are significant, a cost account or work order shall be established to separately identify and accumulate them.

(h) *Subcontractor claims.* Subcontractor claims, including the allocable portion of the claims common to the contract and to other work of the contractor, are generally allowable. An appropriate share of the contractor's indirect expense may be allocated to the amount of settlements with subcontractors; provided, that the amount allocated is reasonably proportionate to the relative benefits received and is otherwise con-

sistent with 31.201-4 and 31.203(c). The indirect expense so allocated shall exclude the same and similar costs claimed directly or indirectly as settlement expenses.

31.205-43 Trade, business, technical and professional activity costs.

The following types of costs are allowable:

(a) Memberships in trade, business, technical, and professional organizations.

(b) Subscriptions to trade, business, professional, or other technical periodicals.

(c) Meetings and conferences, including meals, transportation, rental of meeting facilities and other incidental costs when the primary purposes of the incurrence of the costs is the dissemination of technical information or stimulation of production.

31.205-44 Training and educational costs.

(a) *Allowable costs.* Training and educational costs, including training materials and textbooks, are allowable to the extent indicated below.

(b) *Vocational training.* Costs of preparing and maintaining a non-college level program of instruction, including but not limited to on-the-job, classroom, and apprenticeship training, designed to increase the vocational effectiveness of employees are allowable. These costs include (1) salaries or wages of trainees (excluding overtime compensation), (2) salaries of the director of training and staff when the training program is conducted by the contractor, and/or (3) tuition and fees when the training is in an institution not operated by the contractor.

(c) *Part-time college level education.* Allowable costs of part-time college education at an undergraduate or postgraduate level, including that provided at the contractor's own facilities, are limited to—

(1) Fees and tuition charged by the educational institution, or, instead of tuition, instructors' salaries and the related share of indirect cost of the educational institution, to the extent that the sum thereof is not in excess of the tuition that would have been paid to the participating educational institution;

(2) Salaries and related costs of instructors who are employees of the contractor; and

(3) Straight-time compensation of each employee for time spent attending classes during working hours not in excess of 156 hours per year where circumstances do not permit the operation of classes or attendance at classes after regular working hours. In unusual cases, the period may be extended (see paragraph (h) below).

(d) *Full-time education.* Costs of tuition, fees (but not subsistence, salary, or any other emoluments) in connection with full-time education, including that provided at the contractor's own facilities, at a postgraduate but not undergraduate college level, are allowable only when the course or degree pursued is related to the field in which the employee is working or may reasonably be expected to work and are limited to a total period not to exceed one school year for each employee so trained. In unusual cases the period may be extended.

(e) *Specialized programs.* Costs of attendance of up to 16 weeks per employee per year at specialized programs specifically designed to enhance the effectiveness of managers or to prepare employees for such positions are allowable. Such costs include enrollment fees and related charges and employees' salaries, subsistence, and travel. Costs allowable under this subparagraph do not include costs for courses that are part of a degree-oriented curriculum, which are only allowable pursuant to paragraphs (c) and (d) above.

(f) *Other expenses.* Maintenance expense and normal depreciation or fair rental on facilities owned or leased by the contractor for training purposes are allowable to the extent prescribed in 31.205-11, 31.205-24, and 31.205-36.

(g) *Grants.* Grants to educatinoal or training institutions, including the donation of facilities or other properties, scholarships, and fellowships are considered contributions and are unallowable.

(h) *Advance agreements.* Training and education costs in excess of (1) 156 hours per year per employee for part-time college level training or (2) one academic year for full-time postgraduate studies may be allowed to the extent set forth in an advance agreement negotiated under 31.109. To be considered for an advance agreement, the contractor must demonstrate that the costs are consistently incurred under an established engineering or scientific training and education program and that the course or degree pursued is related to the field in which employees are now working or may reasonably be expected to work.

(i) *Training or education costs for other than bona-fide employees.* Costs of tuition fees, textbooks, and simliar or related benefits provided for other than bona-fide employees are unallowable, except that the costs incurred for educating employee dependents (primary and secondary level studies) when the employee is working in a foreign country where public education is not available and where suitable private education is inordinately expensive may be included in overseas differential.

(j) *Employee dependent education plans.* Generally, costs for college plans for bona-fide employee dependents are unallowable.

31.205-45 Transportation costs.

Allowable transportation costs include freight, express, cartage, and postage charges relating to goods purchased, in process, or delivered. When these costs can be identified with the items involved, they may be directly costed as transportation costs or added to the cost of such items. When identification with the materials received cannot be made, inbound transportation costs may be charged to the appropriate indirect cost

accounts if the contractor follows a consistent and equitable procedure. Outbound freight, if reimbursable under the terms of the contract, shall be treated as a direct cost.

31.205-46 Travel costs.

(a) Costs for transportation, lodging, subsistence, and incidental expenses incurred by contractor personnel in official company business are allowable subject to paragraphs (b) through (f) below. These costs may be based upon (1) actual cost incurred, (2) per diem or mileage, or (3) a combination of (1) and (2) provided the method used does not result in an unreasonable charge.

(b) Travel costs incurred in the normal course of overall administration of the business are allowable and shall be treated as indirect costs.

(c) Travel costs directly attributable to specific contract performance are allowable and may be charged to the contract under 31.202.

(d) The difference in cost between first-class air accommodations and less-than-first-class air accommodations is unallowable except when less than first-class accommodations are not reasonably available to meet necessary mission requirements (such as when less-than-first-class accommodations would require circuitous routing, require travel during unreasonable hours, excessively prolong travel, result in increased cost that would offset transportation savings, or would offer accommodations not reasonably adequate for the physical or medical needs of the traveler).

(e) Costs of travel via contractor-owned, -leased, and -chartered aircraft are subject to the following:

(1) "Cost of contractor-owned, -leased, and -chartered aircraft," as used in this paragraph, includes the cost of lease, charter, operation (including personnel), maintenance, depreciation, insurance, and other related costs. This cost is allowable, if reasonable, to the extent that the contractor can demonstrate that the use of the aircraft is necessary for the conduct of its business and that the increase in cost, if any, in comparison with alternative means of transportation is commensurate with the advantages gained.

(2) Some of the factors to consider in determining the necessity for such aircraft are whether—

(i) Scheduled commercial airlines or other suitable less costly travel facilities are available at reasonable times, with reasonable frequency and serving the required destinations conveniently;

(ii) It is likely that critical or emergency situations might arise that could not be accommodated as effectively by scheduled commercial airline or other suitable less costly travel facilities;

(iii) The increased flexibility in scheduling would result in time savings and more effective use of key personnel;

(iv) National or industrial security demands privacy for key personnel who must work enroute; and

(v) The contract requires flight testing of equipment.

(3) When the need for contractor-owned, -leased, or -chartered aircraft has been demonstrated, additional factors such as the following shall be considered in determining the reasonableness of costs:

(i) The number, type and size of aircraft needed (involved in this determination are matters such as the number and physical aspects of locations to which flights are required, distances of these locations, number of passengers to be carried, and frequency of flights).

(ii) The appropriateness of the method of acquisition, i.e., purchase, lease, or charter.

(iii) Whether, when the contractor has more than one type or size of aircraft, that available aircraft best suited to the requirements of each individual trip was used.

(4) Where the need for contractor-owned, -leased, or -chartered aircraft has been demonstrated, optimum use of such aircraft, rather than scheduled commercial service, should be made where a cost advantage will result to the Government.

31.205-47 Defense of fraud proceedings.

(a) *Definitions.* "Costs," as used in this subsection, include, but are not limited to, administrative and clerical expenses; the cost of legal services, whether performed by in-house or private counsel; the costs of the services of accountants, consultants, or others retained by the contractor to assist it; the salaries and wages of employees, officers, and directors; and any of the foregoing costs incurred before commencing the formal judicial or administrative proceedings which bear a direct relationship to the proceedings.

"Fraud," as used in this subsection, means (1) acts of fraud or corruption or attempts to defaud the Government or to corrupt its agents, (2) acts which constitute a cause for debarment or suspension under 9.406-2(a) and 9.407-2(a) and (3) acts which violate the False Claims Act, 31 U.S.C., sections 3729-3731, or the Anti-Kickback Act, 41 U.S.C., sections 51 and 54.

(b) Costs incurred in connection with defense of any (1) criminal or civil investigation, grand jury proceeding or prosecution, (2) civil litigation, or (3) suspension, debarment or other administrative proceedings, or any combination of the foregoing, brought by the Government against a contractor, its agent or employee, are unallowable when the charges, which are the subject of the investigation, proceedings, or prosecution, involve fraud on the part of the contractor, its agent or employee, as defined below, and result in conviction (including conviction entered on a plea of nolo contendere), judgment against the contractor, its agent or employees, or decision to debar or suspend, or are resolved by consent or compromise.

(c) In circumstances where the charges of fraud are resolved by consent or compromise, the parties may

agree as to the extent of allowability of such costs as a part of such resolution.

(d) Costs which may be unallowable under 31.205-47 shall be differentiated and accounted for by the contractor so as to be separately identifiable. During the pendency of any proceeding or investigation covered by paragraph (b) above, the contracting officer should generally withhold payment of such costs. However, the contracting officer may in appropriate circumstances provide for conditional payment upon provision of adequate security, or other adequate assurance, and agreement by the contractor to repay all unallowable costs, plus interest, if a conviction or judgment is rendered against it.

31.205-48 Deferred research and development costs.

"Research and development," as used in this subsection, means the type of technical effort which is described in 31.205-18 but which is sponsored by, or required in performance of, a contract or grant. Research and development costs (including amounts capitalized) that were incurred before the award of a particular contract are unallowable except when allowable as precontract costs. In addition, when costs are incurred in excess of either the price of a contract or amount of a grant for research and development effort, such excess may not be allocated as a cost to any other Government contract.

ATTACHMENT D
Checklists for Internal Control

The checklists for internal control included in this Manual under Attachment D are provided as a suggested guide for recipient officials in assessing the adequacy of the organization's business management capabilities. The check lists are not all inclusive, but can serve as a resource for ongoing evaluation, as necessary. The types of problems continually cited in audit reports clearly indicate that greater attention must be given to the business management competence of recipient organizations. Proper internal control procedures will provide greater assurance that grant and subgrant awards will be adequately managed and should reduce the deficiencies found in audits of the organization.

1. Personnel Management

- Is an up-to-date organizational chart in use?

- Does the position classification system:

  (1) differentiate between levels of responsibility and complexity of work?
  (2) require position descriptions and job titles?
  (3) identify position requirements?
  (4) call for periodically reviewing and updating position descriptions?
  (5) divide duties among employees responsible for the procurement, approval, verification (pre-audit) and disbursement functions of expenditure transactions?

- Does the recruitment and selection system:

  (1) provide for the announcement of vacancies to staff as well as other known sources of manpower?
  (2) establish controls to ensure consistency with the budget plan?
  (3) enable a comparison of job candidates with the budget plan?
  (4) establish procedures for applicant interviews, reference checks and final selection by an appropriate official?
  (5) evaluate the effectiveness of compliance with Title VI of the Civil Rights Act of 1964, as amended?

- Is the compensation determination based on analysis of:

  (1) job requirements?
  (2) comparability with similar work in the local labor market?
  (3) periodic review of pay scales?
  (4) fringe benefits comparable to other similar organizations?

- Does the performance rating system:

  (1) establish performance standards?
  (2) require periodic rating?
  (3) form the basis for consideration of future pay adjustments?

- Is the merit promotion plan based on increased responsibility and employee qualifications?

- Does the staff utilization and career development program:.

  (1) require analysis of manpower needs and staff use?
  (2) provide job training or retraining where applicable?
  (3) provide career counseling?
  (4) provide supervisory training?

- Is there a clear, consistent written policy with respect to:

  (1) working hours?
  (2) work schedules?
  (3) overtime?
  (4) vacation schedules and other absences?
  (5) maintenance of attendance records for all employees, with proper supervisory controls?
  (6) travel (including transportation, subsistence and lodging)?
  (7) training?
  (8) outside employment?
  (9) permitted and prohibited political activity, if covered by the Hatch Act?

- Does the personnel relations program include:

  (1) open channels of communication for distribution of information, expression of grievances, and the encouragement of ideas for organizational improvement?
  (2) written standards for employee conduct and conflict of interest?
  (3) a fair and equitable disciplinary system to handle conduct violations?
  (4) the provision of medical services to all employees, as appropriate?

- Does the file and records system include all official documents related to the employment of each staff member and other persons participating in grant supported activities?
  (Such records should be maintained in an orderly and accessible file system which is capable of providing necessary information to supervisors, accountants, and auditors, as well as employees. Among the documents which would be included in these are actions related to hiring, dismissal, promotions, commendations and adverse actions.)

2. Payroll

- Is the payroll checked at regular intervals against the personnel records?

- Are clerical operations involved in the preparation of payroll checks double-checked before checks are distributed?

- Are the functions involved in the preparation of payroll distributed among a number of employees? Are the duties of those preparing payrolls rotated?

- Are the unclaimed paychecks properly controlled?

- If a separate payroll bank account is maintained, is it reconciled by an employee independent of all other payroll preparation functions?

- Does the procedure followed in reconciling the payroll bank account include the checking of names on payroll checks and of endorsements against payroll records?

- Are payroll checks distributed by someone other than persons who prepare payrolls, supervise employees, approve time reports, or sign paycheck?

- Is the bank instructed not to clear payroll checks over 30 days after date issued?
- Are occasional surprise distribution of paychecks made by an independent employee having no financial duties?
- Are payroll checks always prepared after receipt of approved time-and-attendance reports and based on those reports?
- Is the issuance of any payroll checks before approved time-and-attendance reports have been received expressly forbidden?
- Is each new employee personally interviewed by both the department in which s/he is to work and by persons independent of that department?
- Are controls over employee termination adequate to prevent the continuance of pay for an employee no longer working?
- Where over 50 employees are on the payroll, are other methods or precautions applied to preclude the possibility offictitious or nonworking employees being added to the payroll?
- Is an adequate current record maintained of all personnel and pay rates?

3. Accounting

- Is the accounting routine set out in an accounting manual?
- For small recipients, is the financial system designed, at the minimum, so that no one person has access to all financial operations, procedures, and records?
- Are sources and application of Federal and non-Federal funds identified in the accounting system (§ 74.61 (b):

  (1) authorizations?
  (2) funds received (including program income)?
  (3) reimbursements?
  (4) obligations?
  (5) unobligated balances?
  (6) assets (including depreciation or use allowances)?
  (7) if applicable, grant-related income?

- Does the accounting system accumulate and record the direct costs of each Federally-supported project for both Federal and non-Federal costs?
- Are individual cost elements in recipient's chart-of-accounts reconciled to the cost categories in the approved budget?
- Does the accounting system identify and segregate unallowable costs?
- Are accounting records supported by source documentation? (§ 74.61(g))
- Are separate program activities or program accounts documented in the accounting system?
- Are transactions recorded and posted in the accounting books and records as frequently as possible, but at least every thirty days?
- Is the accounting function completely separated from procurement (purchasing) and receiving?
- Are general journal entries approved by a responsible employee?

4. Budget

- Are there procedures to determine the allowability, allocability, and reasonableness of costs? Are the procedures verified and/or approved by a responsible official?
- If costs have been transferred within the approved budget since the last award, are the transfers supported by justification or documentation?
- Was prior approval obtained on costs requiring same?
- Were any obligations for the current budget period incurred prior to the effective date?
- Are budgeted costs compared with actual costs (for both Federal and non-Federal costs)?
- Is action taken when the comparisons disclose problems?
- Are budgetary controls in place to preclude incurring obligations in excess of total funds available for (1) grant and (2) object class category?

5. Cash Management

- Is there more than a three day lapse between the advance of grant funds and expenditures?
- Are separate or special purpose bank accounts controlled? (Special accounts may be used as needed but should be under same control as the regular accounts.)
- Are all cash receipts immediately recorded upon the books?
- Are cash receipt books properly controlled and safeguarded?
- Are validated duplicate deposit slips obtained for each deposit?
- For small recipients, are certain functions such as receipt of bank statements, preparation of bank reconciliations, etc., carried out by independent bookkeepers or others for internal control purposes?
- Are bank statements received directly, unopened by the person who prepares the bank reconciliation?
- Are bank statements reconciled at least monthly?
- Are paid checks examined for date, name, cancellation, and endorsements at the time the reconciliation is prepared?
- Do supporting data accompany checks when they are submitted for signature?
- Are supporting documents cancelled to prevent subsequent use?
- Are vouchers or supporting documents identified by grant number, date, and expense classification?
- Are invoices or vouchers approved in advance by responsible department heads?
- Is the sequence of check numbers accounted for when bank account is reconciled?
- Is the bank instructed not to pay checks over 30 days after date shown on check?
- Are voided checks properly mutilated and retained for subsequent examination?

- Are blank checks properly controlled?
- Is the practice of drawing checks payable to "cash", "petty cash", "bearer" etc. prohibited?
- Are authorized signatures limited to persons who have no access to accounting records or to petty cash?
- If a mechanical or facsimile signature is used for disbursements, is the signature plate, die, key, etc. under adequate control?
- Is the issuance of checks on only verbal authority prohibited?
- Is the signing of checks in advance prohibited?
- Are employees prohibited from having custody of any unrecorded cash or negotiable documents (other than their own personal money) while on the premises of the grantee?
- Is responsibility for any petty cash fund vested in only one person?
- Are signed vouchers obtained written in ink for all petty cash disbursements?
- Is the maximum amount of any individual disbursement limited to $20.00 or to another reasonable amount?
- Are the amounts of petty cash funds limited so that reimbursement is required at relatively short intervals (not over 2 weeks)?
- Are petty cash vouchers cancelled or marked so as to preclude their reuse?
- Is petty cash kept locked at all times when not in use?
- Are employee loans prohibited?
- Are employee travel advances or other types of business advances accounted for promptly?

6. Procurement (Purchasing)

- Are the organization's purchasing practices and policies in writing in a purchasing manual?
- Is a separate purchasing department maintained?
- If not, is the responsibility for procurement assigned to one individual?
- Is the prenumbered sequence of used purchase orders accounted for?
- Does a copy of the receiving report go directly to the accounting office when goods are received?
- Are invoices checked in the accounting office against purchase orders and receiving reports?
- Is there definite evidence of responsibility for verifying invoices as to prices, extensions, additions, freight charges, discounts, etc.?
- Is account coding double-checked prior to disbursement?
- Are vouchers examined by a responsible individual to ascertain completeness of attachments and various required approvals?
- Are vendors' invoices delivered directly to the accounting office?

- Are purchases for employees expressly prohibited?
- Are purchase invoices routed through a voucher register and not directly through cash disbursements?
- If a voucher register is maintained, is it balanced monthly with the general ledger control account?
- Is a postage meter used for outgoing mail?
- Are controls established over use of any duplicating and photocopying equipment, and are quantities of material used or copies made accounted for?
- Are voided purchase orders mutilated and retained for future examination?
- Are purchase orders outstanding periodically reviewed and outstanding old orders accounted for?
- When competitive quotations are required in accordance with procurement policy, are they properly obtained?
- Are expenditure transaction files maintained in such a manner that documents supporting any transaction can be easily located?
- Is a master list maintained of all persons authorized to sign or approve purchase requisitions, purchase orders, receiving reports, invoices (approval for payment, time-and-attendance records, etc.), and are signature samples available for comparison?
- Are goods and services received prior to payment?
- Are small and/or minority businesses used as sources of supplies and services?
- Have sole source procurements been approved by the granting office?
- Have price or cost analyses been performed on all procurements?
- Has a lease vs. purchase analysis been made before procuring equipment?
- Prior to the purchase of equipment with grant funds, does an authorized grantee official certify that no similar equipment is on hand?
- Are the required conditions or provisions contained in contracts awarded by the organization?

7. Property Management

- Are the organization's property policies in writing in a property Manual?
- Are the proper classifications made between equipment and supplies and reconciled to the grantee's budget?
- If equipment is "on loan" or "shared" with other organizations, are costs allocated proportionally?
- Is a complete physical inventory of property taken at least every two years?
- Are the results reconciled with the property records?
- Where inventories are of great significance or where a central warehousing system is used, are perpetual inventory records maintained?
- Is property adequately tagged or otherwise identified?

- Is the property ledger maintained so that any item of property can be located and identified?
- Is the property ledger balanced monthly against the appropriate general ledger accounts?
- Are retirements and disposals properly approved and recorded?
- Are the proceeds of any liquidated property properly recorded?
- Is damaged or lost property properly treated on the accounting records?
- Are insurance recoveries properly recorded?
- If inventories of consumable supplies exceed $500 in value, have adequate controls been established?
- Is equipment properly safeguarded?
- Are only depreciation or use allowances charged for grantee-owned buildings or buildings donated as a third-party in-kind contribution?

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